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INDUSTRIAL DEVELOPMENT BANK

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ROYAL COMMISSION ON BANKING

AND FINANCE

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Hearings held at Ottawa, Ontario, on Tuesday, January 22, 1963.

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THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W. A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

- - - - - -

Mr. H. A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

Ottawa, Ontario,
Tuesday,
January 22, 1963.

--- At 9.15 A.M. the hearing resumed.

SUBMISSION OF

INDUSTRIAL DEVELOPMENT BANK

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APPEARANCES

L. Rasminsky	-	President, Industrial Development Bank
J. R. Beattie	-	Director, [illegible], Industrial Development Bank
A. N. H. James	-	General Manager, Industrial Development Bank
E. R. Clark	-	Assistant General Manager, Industrial Development Bank
L. F. Mundy	-	Secretary, Industrial Development Bank

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THE CHAIRMAN: We shall now resume to consider the submission of the Industrial Development Bank. Will you proceed, Mr. Rasminsky?

MR. RASMINSKY: Mr. Chairman, may I first introduce my associates? On my right is Mr. Beattie who is a member of the Board of Directors and a member of the Executive Committee of the Industrial Development Bank. Mr. Beattie acts as

my alternate as president of the Industrial Development Bank. Mr. James is the general manager; Mr. Clark is the assistant general manager, and Mr. Mundy is the secretary of the Industrial Development Bank.

Mr. Chairman, the Industrial Development Bank has placed before the Commission a submission dated October 3, 1962, which has been in your hands for some time and which I am sure the Commissioners have had an opportunity of reading. I do not propose, unless you wish me to do so, to summarize the submission which is, in itself, fairly brief. If it suits your convenience we are now prepared to answer any questions you have to ask us.

THE CHAIRMAN: Yes, I do not think it is necessary for you to summarize the brief. We will proceed.

COMMISSIONER GIBSON: Mr. Chairman, may I start by asking a few questions about the general background and the lending policy of the Industrial Development Bank. Mr. Rasminsky, at page A-1 of your submission you outline the origin of the Industrial Development Bank. You explain that there was a gap in the financing available to small and medium-sized businesses. You explain that there was credit available for such businesses in the banking system but that longer term funds were generally not available, the capital market being available for only larger businesses. How far does this gap still exist, in your opinion? Is the I.D.B. still trying to fill the same gap that it was originally?

MR. RASMINSKY: I think that percentagewise the gap must be smaller than it was when the Industrial Development Bank was set up, Mr. Gibson, because since that time a number of new institutions which are especially directed towards meeting the requirements of small business have been established, and some existing institutions have extended the sphere of their activity into the industrial field, which is one of the fields covered by I.D.B. lending.

However, it is our experience that within the terms of reference of the Act itself, namely, that the purpose is to help essentially viable enterprises that are capable of making a profit to obtain capital in circumstances where capital is not otherwise available on reasonable terms and conditions, the Industrial Development Bank is attempting to partly fill a still very considerable gap which is due, no doubt, to the growth in the size of the economy.

COMMISSIONER GIBSON: Would it be fair to say that the Industrial Development Bank has been making a more vigorous effort to fill this gap in recent years? You refer, in particular, to the great increase in scale of the I.D.B.'s operations in the last two or three years. Page D-3 shows that there has been a tremendous increase in the number of loans made per annum, particularly in 1962, but also in 1961. From page F-4 it appears evident that there has been a very marked increase in staff, and also in the brief a very vigorous pro-

gram of staff development is described.

MR. RASMINSKY: Yes, I think the statement you have made is fair, Mr. Gibson. In accordance with the decisions of parliament taken from time to time, the scope and the scale of I.D.B. operations have been increased. These decisions that I refer to are various amendments to the Act that have progressively increased the sphere of eligibility for I.D.B. credits.

Originally, as you know, the credits were largely confined under the terms of the Act to loans to manufacturing enterprises. Later amendments extended that sphere in various ways by making air transport, for example, eligible, and they culminated in the amendment of July, 1961, which, in effect, made any business enterprise, including the service industries, eligible for I.D.B. financing. That is the extension that has taken place in the scope of I.D.B. financing.

A similar extension has taken place, under a decision of parliament, in the size and the scale of operations. Under the original Act the capital of the I.D.B. was limited to $25 million, all of which, as you are aware, is owned by the Bank of Canada. There is a limitation on the issue of debentures by the I.D.B., the limitation being related to the size of the capital and the rest fund.

Until the 1961 amendment to the Act, one could have thought of the I.D.B. as being a hundred million dollar bank. Under the 1961 amend-

ment the share capital was increased to $50 million, and the combination of the share capital and the rest fund and the appropriate multiplier of the possible issue of debentures has had the effect that the potential of the Industrial Development Bank as a lending institution was substantially increased, and it is now approximately $400 million.

COMMISSIONER GIBSON: And this has been reflected in a general increase in the scale of operations -- not just in an extension of the scope of the operations, but in a more active operation in the original field? I note, for example, that in the table on page D-3 in 1961 and 1962 the number of loans to manufacturers was at a very much higher level than in previous years.

MR. RASMINSKY: That is a reflection of the fact that the number of loans to manufacturers has increased even though the percentage of loans to manufacturers declined.

COMMISSIONER GIBSON: Yes, the scale of the thing is a good deal bigger?

MR. RASMINSKY: That is right, Mr. Gibson. With the growth of the economy and with the operating usefulness of the early loans made by the Industrial [illegible] rposes of the Act the scale of operations has been increased. There is, of course, further evidence of the increase in the scale of operations in the increase in the number of branches of the Industrial Development Bank. That is referred to on page F-4 of the submission, and it

is shown in detail in the annex.

COMMISSIONER GIBSON: You make a point in the brief that the proportion of smaller loans -- that is the proportion in terms of numbers of smaller loans -- has increased

and you point to the costliness, in effect, of this. I take it you are also making, although not as large a proportion, a substantially larger absolute number of medium-sized and larger loans, too; is that correct?

MR. RASMINSKY: Yes, that must be correct.

COMMISSIONER GIBSON: We have been told you had been doing that by some of your competitors on several occasions.

MR. RASMINSKY: We do not regard them as our competitors.

COMMISSIONER GIBSON: Well, they regard you as competitors to some degree, in any event.

MR. RASMINSKY: I think we have some information in the brief on the number of larger loans, Mr. Gibson. Table 11 of the submission shows, [illegible] I do not know what [illegible]

[illegible] and [illegible] half the loans made by the I.D.B. are $25,000 or less. Nevertheless, the absolute number of larger loans has, as you have indicated, increased.

If one takes, say, loans over $200,000 as larger loans, and if one makes a comparison over

the last ten years it will be seen that in 1952 and 1953 the bank made in both of those years nine loans of over $200,000, and in the last couple of years, the bank has made about forty loans over $200,000. There were 37 in 1961, and 41 in the fiscal year ending September 30, 1962.

COMMISSIONER GIBSON: In terms of value of total loans outstanding -- that is, amount -- something like 60 per cent of your loans are over $50,000. That is a very rough calculation. It is 46 out of 71 in 1961, and that is over 60 per cent.

MR. RASMINSKY: Over $50,000?

COMMISSIONER GIBSON: Yes.

MR. RASMINSKY: I said that $43,000 is the average size of the loans, but I see from the table that it was $44,000.

COMMISSIONER GIBSON: This table shows the average size was $52,000 in 1961.

MR. RASMINSKY: $44,000 in 1962.

COMMISSIONER GIBSON: We have not the 1962 figures here. Are they in the report?

MR. RASMINSKY: We put in a revised submission.

MR. BEATTIE: The fiscal year ended on September 30, so at the time the submission was written we did not have the final figures for 1962.

COMMISSIONER LEMAN: We have them in your annual report.

MR. BEATTIE: Yes, and a revised submission was put in. It was revised only in the

sense of putting in the final figures for the fiscal year, 1962.

COMMISSIONER GIBSON: We now have the 1962 figures, and the average size of the larger loans -- that is, loans of over $200,000 -- was approximately $400,000 in 1961, and about $300,000 in 1962. Is that typical of these larger loans, or are there some very big ones, and some rather smaller ones?

MR. JAMES: I would say that the larger loans are roughly from $300,000 to $400,000. In this particular grouping there is one which was just in excess of $1 million, but by and large they run under $500,000. I would say that $300,000 is just about the average.

COMMISSIONER GIBSON: When the scope of the I.D.B.'s powers was enlarged there was a certain amount of reference to the problem of the purchase of Canadian firms by foreigners, and it was indicated that the I.D.B. might endeavour to keep Canadian industry in Canadian hands to the degree that lay within its powers. Were any of these larger loans for that purpose?

MR. BEATTIE: A few were, Mr. Gibson. We have not had as many proposals placed before us for that particular purpose as one might have expected, but it is not for any lack of willingness to consider them that there have not been more loans of this kind put on our books.

COMMISSIONER GIBSON: This, of course, is

a completely different consideration from the ones that the I.D.B. has had through most of its history, and it is one that could involve a very large transaction if it was put before the I.D.B. There is no limit on the size of such a proposition.

MR. BEATTIE: Except that where market financing is possible those tend to get outside of our field.

COMMISSIONER GIBSON: Except when market financing might turn out to be more feasible in the United States, and that is the one thing you are trying to prevent.

MR. BEATTIE: All I can say is that no really large proposition of this kind has come to us. They have tended to be in the same range of size as that about which we have been talking -- $300,000, $400,000 or $500,000.

COMMISSIONER GIBSON: Would you care to say something about the Industrial Development Bank in relation to the field of provincial development funds that have started in Canada. Are you doing a [illegible] there is one [illegible] British [illegible] these funds? Are your activities fairly closely integrated with them?

MR. BEATTIE: We do have a quite close and friendly relationship with all of these provincial organizations, Mr. Gibson. Their field of activity has changed from time to time, and I think

in many cases they tend to regard themselves as being rather in the role of residual lenders back of the I.D.B. I know that some of them require evidence that the applicant has been to the I.D.B. There is often consultation or mutual discussion between us in regard to an application of this sort. In general, I think I can say that there is a co-operative working relationship between the two organizations. The provincial organizations will naturally be closer to and more concerned with particular local factors that are involved.

COMMISSIONER GIBSON: I got the impression, since your capital resources have been expanded and the number of your branches has been increased, that you have taken some of the burden off these funds. In our hearings we got the impression that some of them were quite appreciative of the extension in I.D.B. activity.

MR. BEATTIE: Yes, I think that is a fair statement. The increase in our activities and the better service we can provide through having more branches has taken a bit of the load off them and has perhaps enabled them to concentrate their attention on the more specialized kinds of risks that come forward.

COMMISSIONER GIBSON: Your standards are identical regardless of whether the provincial development funds are available, I take it?

MR. BEATTIE: Yes. The non-existence of provincial development funds would not influence the way in which we operate. We do endeavour to make all loans we can in every part of the country within the scope that is given to us, the field that is allotted to us under the Act. There is no holding back in one place of the country in favour of another.

COMMISSIONER GIBSON: You use approximately the same approach in each part of the country?

MR. BEATTIE: Yes. I think if anything we would press a little harder to fulfil our complete role in the outlying parts of the country than in the more highly developed sections where other facilities are more readily available. I would not want to make very much of that fact, but if anything we tend to try a little harder in outlying areas.

COMMISSIONER GIBSON: But, by definition, in your policy you would not do relatively as much in the areas where better facilities are available? I mean, you have referred to funds being available from other sources. I should like to go into this in more

detail, but you do say that if they are available from other sources on reasonable terms it is not your function to finance them. Now, this would be the case in areas where funds are more available than in others?

MR. BEATTIE: Yes, but there are still a great many enterprises, particularly among the very small ones, which are not able to get financing of the kind they need from existing sources, even in Toronto and Montreal.

COMMISSIONER GIBSON: I appreciate that. You say you try a little harder in the outlying areas.

MR. BEATTIE: Yes, within the field that is set aside for us to work in.

COMMISSIONER GIBSON: That is, you actually make greater effort in some parts where you feel the needs are greater?

MR. BEATTIE: I said "if anything". I would not want to make a great deal of this but our bias, if there is a bias, would be in that direction.

MR. RASMINSKY: It really comes to what you indicated, Mr. Gibson, that it is likely to be the case that in the outlying areas when funds are indeed not as readily available, nor available on terms and conditions that are reasonable, as in the more highly industrialized areas, there is a greater need there for the Industrial Development Bank to fulfil a role in those areas.

COMMISSIONER GIBSON: Could you say anything about your function in relation to corresponding activities in the United States? This comes under several

heads in United States, as I understand it. Have you looked at this from a comparative point of view?

MR. JAMES: Are you referring particularly to the S.B.A., and that kind of thing, in the United States?

COMMISSIONER GIBSON: Yes.

MR. JAMES: We work along very similar lines. It is rather curious in a way that while they do very much greater volume than we do in many ways in direct relationship to their greater population, one major difference is that they will not make a direct loan if they can get a local bank to participate in that loan. That, I think, is one of the major differences.

MR. BEATTIE: Is it not the case, Mr. James, that on a per capita or per unit of G.N.P. basis, their activities are quite appreciably smaller than others?

MR. JAMES: In some ways they are, yes.

MR. BEATTIE: Their total extensions are about four or five times ours, are they not?

COMMISSIONER GIBSON: You are talking about the Small Business Administration?

MR. BEATTIE: Yes.

COMMISSIONER GIBSON: What about the Small Business Investment Corporation?

MR. JAMES: The S.B.A. supplies a certain amount of capital and loan funds to that organization.

COMMISSIONER GIBSON: Are you counting this in this calculation?

MR. BEATTIE: No. They have not amounted to very substantial figures yet.

MR. JAMES: No. Their loans are not very, very high. They have incorporated just over 600 of them, but the amount of money is not really tremendous.

MR. BEATTIE: In relation to the size of the country I think less is being done in the United States than here, and by quite a margin.

COMMISSIONER GIBSON: Is there any difference in their approach? You say the American administration will not make a loan if a local bank is prepared to make one.

MR. JAMES: By statute the S.B.A. is not permitted to make a loan unless it can be shown that participation by a bank or other lender that is taking part of the loan, let us say 10 or 20 per cent, is not available. Another thing ---

MR. RASMINSKY: Excuse me. Before you go on to that may I say that in a sense we have the counterpart of that provision in our set-up, Mr. Gibson, in this respect that before the I.D.B. will make a loan it requires a report on the applicant from the chartered bank of the applicant. This report, together with such detailed information as we may get, serves the double purpose of providing the Industrial Development Bank with information regarding what the credit standing of the applicant looks like to the chartered bank. Secondly, it serves the purpose of putting the chartered bank on notice that the Industrial Development Bank is contemplating making a loan. Therefore, if the chartered bank wishes to make the loan the chartered bank has an opportunity of doing so and, since the

maximum rate that the chartered banks can charge is less than the I.D.B. rate, the desire would be on the part of the applicant to take the money from the chartered bank rather than from the Industrial Development Bank. Therefore, under our set-up it can be taken for granted that the I.D.B. makes no loan that the chartered bank would be willing to make.

COMMISSIONER GIBSON: Yes. I should like to deal with that in a minute, but I do not quite understand what you were saying, Mr. James, about the Small Business Administration not making a loan unless another lender took some part of it or unless another lender would not take part of it.

MR. JAMES: Unless another lender refuses to take part, and then they can make a direct loan.

COMMISSIONER GIBSON: Do they make loans in which other lenders participate?

MR. JAMES: Oh, a very great proportion of their business is in that category.

COMMISSIONER GIBSON: I don't understand the restriction, then.

MR. JAMES: By statute the S.B.A. is not permitted to make a direct 100 per cent loan unless it is shown that a participation of banks, of other lenders, is not available. The other participant's share of the loan must be at least 10 per cent. The Banks participate in approximately 60 per cent of the loans approved by the S.B.A. at the present time. The S.B.A. cannot make a direct loan to an applicant unless the applicant has been fully turned down by at least

one other bank.

COMMISSIONER GIBSON: They have to be first turned down by the other lender?

MR. JAMES: That is right.

COMMISSIONER GIBSON: And then they come in perhaps as a participant with the other lender?

MR. JAMES: With the S.B.A., yes. They will only make a full direct loan if another bank will take no part in the participation.

COMMISSIONER GIBSON: Going on to the question of the terms on which the Industrial Development Bank makes loans, the matter which you were talking about, in part, Mr. Rasminsky, the basic point which is made in A-2 and developed in pages B-3 to B-5, is that the I.D.B. will only make a loan available when it is satisfied that the credit being applied for is not available elsewhere on reasonable terms and conditions. This is outlined on A-2 and is developed in various ways in other sections of the brief. Is this still a basic policy?

MR. RASMINSKY: Yes, sir.

COMMISSIONER GIBSON: There is no change in this basic policy or there is no change in the emphasis?

MR. RASMINSKY: No, Mr. Gibson.

[illegible] a great deal of emphasis put in the brief on seeing if other people are prepared to make such loans. You just mentioned you get a report from a bank and if the bank is prepared to make the loan, the applicant presumably will go to the bank because the rate of interest is a

little lower there. How far do you go in finding other lenders or in satisfying yourself that the applicant has in fact explored the field of other lenders, say, mortgage lenders?

MR. RASMINSKY: It might be helpful to the Commission if Mr. Beattie were to make a general statement on this subject of reasonable terms and conditions, which subject lies very close to the heart of the operations of the Industrial Development Bank.

MR. BEATTIE: Under the terms of the Industrial Development Banks Act of Incorporation, as you know, it must, before entertaining an application for financing, satisfy itself that the funds cannot be obtained elsewhere on reasonable terms and conditions. That always has been a basic feature of the act and in its operation. In the case of all applications the I.D.B. requires a signed declaration from the applicant to this effect, namely, that he cannot get the funds elsewhere on reasonable terms and conditions.

In the case of applications for large amounts, or in cases where the circumstances suggest that financing might be available elsewhere, the I.D.B. also requires the applicant to discuss his problem with several appropriate outside lending organizations, depending on the kind of expenditure he has in mind and the security he is able to put up, and so on, and requires him to produce documentary evidence from those outside lending organizations that the funds are not available at all or that if they are available, in the words of the Act, they are not on reasonable terms and conditions.

This has still left quite a large field for the Industrial Development Bank to operate in, for most financial organizations tend to specialize in particular kinds of loans, for example, for land and buildings, machinery and equipment, or for working capital.

The I.D.B. facilities enable it to meet the overall term financing needs of a business, which usually includes money for several or all of these purposes in a way which few other organizations do. This is particularly true in the case of small businesses. Perceptibly over half of the loans now being made by the I.D.B. are for amounts of less than $25,000. The I.D.B. can provide a wide variety of financing "packages" and frequently lends a larger amount in relation to the cost of a program than other organizations can do.

The Industrial Development Bank is flexible as to the kind of security it takes, and the amount and term of its loans are geared not only to this security but to its estimate of the overall capacity of the business to generate funds for repayment during the period of the loan.

Where the loan desired by the applicant is available from another source but on terms and conditions which the applicant does not regard as reasonable, then [illegible] ion on this point.

In most cases where the I.D.B. decides that the terms are not reasonable, and ultimately makes the loan, the question at issue is whether the

period of repayment offered by the alternative lender is such as to put too great a strain on the anticipated earnings of the business.

The funds may be available from an alternative source, for, say, three years when the prospective earnings of the business indicate that a term of, say, six years would be needed, and when these earnings of the business and the total security of all kinds which it can provide indicate that in the actual experience of the I.D.B. the longer term would be acceptable from a credit point of view.

The reasonableness of the terms and conditions must therefore be assessed in relation to the prospective earnings of the business as well as the amount of the loan, and the nature of the security provided, the rate of physical depreciation of the assets in question and any other relevant factors that there may be.

The occasions on which the question of "reasonableness" hinges solely on the interest rate are very few in number. We have found in practice that other considerations really decide this question before you get around to looking at the interest rate at all, except on very few occasions.

COMMISSIONER MacKEEN: Mr. Beattie, you mentioned [illegible] ...ective borrowers go to. How are they selected, by the Bank or by the client?

MR. BEATTIE: The client may already have had some negotiations or discussions with an outside lender. In that case we would ask him to press this

to the point of decision and get documentary evidence as to what the decision was. On the other hand, if he had not taken this initiative we would endeavour to suggest to him two or three or four institutions operating in the kind of lending field that fitted his particular case, which he should go to and have discussions with and ultimately get this documentary evidence. We prefer not to give names, but if the man presses us we will have to give him a range of names from which he can choose. We prefer not to direct him to specific institutions. We suggest, first of all, the kind of institutions he should approach, but if he keeps on pressing for more specific directions then ultimately we have to give him a short list of names from which to choose.

COMMISSIONER MacKEEN: The small borrower might be ignorant of the type of institutions he should go to.

MR. BEATTIE: Yes, and we try to remedy that so far as we can, without naming names, if we can avoid it.

COMMISSIONER GIBSON: Conceivably a larger [illegible] in some areas, such as

who take an interest in these things. There is a problem of finding where the money might be available, and sometimes it is quite a serious problem.

MR. BEATTIE: Yes. We would try to perform the same function there that we would for a very small

borrower, although usually the need is somewhat less there. The larger borrowers are more sophisticated about such things.

COMMISSIONER GIBSON: When you say you go to larger borrowers to produce documentary evidence that funds are not available, this means a letter from the various people from whom they have applied for a loan?

MR. BEATTIE: Yes.

COMMISSIONER GIBSON: And you would want evidence that they had applied to several people in the area?

MR. BEATTIE: Yes.

COMMISSIONER GIBSON: You say one of the reasons for the effectiveness of your lending -- you did not put it this way, but it means this -- is that the I.D.B. is often ready to make loans larger in relation to the size of the programme than other lenders. This is very frequently the case, I take it, is it?

MR. BEATTIE: Yes, I think this is quite often a feature of the situation. Chiefly for two reasons: firstly, the I.D.B. has considerable flexibility as to the kind of security it takes, and it has not confined itself to one type of security; and, secondly, it has by now had considerable experience in estimating the respective earning power of various kinds of small businesses and forming a view as to what their re-payment capacity is.

COMMISSIONER GIBSON: Thinking of it in terms of ratio to fixed assets, which might be mortgages, would there be many occasions when you would lend more than a conventional mortgage lender would be permitted to lend against those fixed assets?

MR. BEATTIE: Yes, quite a few times.

MR. RASMINSKY: In such cases we would probably have some additional security beyond the fixed asset itself.

COMMISSIONER GIBSON: Beyond the fixed asset?

MR. RASMINSKY: Yes. We are empowered under the Act to take security on

movable equipment, to take a chattel mortgage. There might be cases where we would take personal guarantees or the proceeds of life insurance, so that it would not be, I think, quite right to say that on real estate security we would set our sights higher than a conventional lender. On a loan involving real estate securities there might be cases where a borrower was able to raise more money from the I.D.B. than he could from a conventional lender, but his borrowing from the I.D.B. would in many cases involve security other than real estate.

COMMISSIONER GIBSON: In addition to real estate?

MR. RASMINSKY: Yes, in addition to real estate.

COMMISSIONER LEMAN: Mr. Gibson, may I interject something here?

Does this suggest that perhaps the lack of flexibility that other lenders had before in the types of security they could take was, in part, responsible for the gap that existed?

MR. BEATTIE: It would have something to do with it, but also involved, I think, is the development of [illegible] in dealing with this kind [illegible] a complex and difficult one, and the process of investigation is often quite costly and time-consuming.

COMMISSIONER LEMAN: One cannot develop the skills and experience necessary unless one knows ahead of time the various types of security required

are available to one.

MR. BEATTIE: Quite.

COMMISSIONER LEMAN: I am just wondering if you would agree this might have been the reason why the gap existed, and which made the existence of the I.D.B. necessary or useful, in the first place.

MR. BEATTIE: I think that would be part of the reason. All these companies, of course, are exceedingly busy doing the specialized kind of lending that they engage in. Most of them have to turn cases away which they would like to accept.

COMMISSIONER MACKINTOSH: Is it fair to say there were rigidities of powers and also of mind accounting for the gap into which you came? Institutions which might have a power to do this and had not been accustomed to, did not think in those terms?

MR. BEATTIE: I think in most cases they had more than adequate outlets for all the funds at their disposal in fields in which they normally operate.

MR. RASMINSKY: An additional factor involved, I think, must be the one Mr. Beattie has [illegible] loans are not particularly profitable loans, that the amount of expense involved in deciding whether to make the loan or not -- the amount of investigation expense and the amount of administration expense -- would make many of these loans that the I.D.B. makes relatively

unattractive to conventional lenders, even if they had the power to take additional security. That would not be true in all cases, but in many of the loans that the I.D.B. makes our feeling is that that would be the case.

COMMISSIONER GIBSON: In this area do you have many package deals with a conventional lender, let us say? I get the impression from your comments in the brief that every once in a while you pay off somebody else in order to get a clear security position and one single loan that is repayable over what is called a suitable period. Presumably it is more difficult to do a package job, but you do it. You say, "If you can get money at the conventional rate up to a certain amount, you had better get it, and we will work out a separate deal for the additional amount you need."

MR. JAMES: Yes, on many occasions we work out those package deals, sometimes by paying off a portion of a prior lien, very often by leaving liens in existence, and on occasion, particularly in realty mortgages, we have taken a secondary position behind a first mortgage. We try to tailor each particular case to the needs of the business.

COMMISSIONER GIBSON: When you do that you have a problem of sharing the security?

MR. JAMES: We rarely go and take part of, let us say, a first mortgage. We would normally leave that and take a second mortgage; but in that case there would be security ahead of us, and in a

few cases where we have done that we have to realize that at some stage we might have to pay off that first mortgage.

COMMISSIONER GIBSON: There would be some cases where the borrower could get funds on a first mortgage from a conventional lender where there might be other security you could take, such as a floating charge on movable or fixed assets.

MR. JAMES: And reinforcing it, perhaps, occasionally with a mortgage behind the first mortgage.

COMMISSIONER GIBSON: Depending on the size of the loan?

MR. JAMES: Yes, in the particular case.

COMMISSIONER GIBSON: I take it you try not to do it this way, or you prefer not to do it this way?

MR. RASMINSKY: I think we would look at each case. In many cases the total amount of lending that can be done will turn out to be greater if it is done by a single lender, if the I.D.B. is not in the position of getting behind a first mortgage and, in a sense, guaranteeing the first mortgage by its own participation. Though, as Mr. James has indicated, there have been some cases where it has seemed that there is enough additional security left over to make our position safe. I think the answer to your question would be that we would look at each case on its own merits.

COMMISSIONER GIBSON: Mr. Beattie emphasizes, and the brief also emphasizes, that there

is very frequently a problem in working out a loan, and money may be available outside but for a shorter term than seems appropriate to the earning capacity of the business. Do you ever think in terms of a shared loan with a conventional lender, where the private lender might take the payment for the first three years and the I.D.B. for the last three years? I am thinking of the way in which municipal financing is sometimes done. The banks often take the short end of it and various other lenders the longer pieces. Do you ever do that?

MR. BEATTIE: I do not think we have had any propositions of that sort put up to us. We would have an open mind about it, if we were approached. In all these appraisals, the prospective earnings of the business are of supreme importance.

COMMISSIONER GIBSON: It is true of any lender if he is going to get money back without any trouble he must make a decent appraisal of what the business is likely to earn.

MR. BEATTIE: Quite, but I am sure we would examine any such proposition with an open mind if it were put up to us.

COMMISSIONER GIBSON: It seems to me that is one of the possible ways in which this sort of problem you mention might be looked at, and I just wondered if anything could be done along those lines? We have heard quite a little about the competition of the I.D.B. with other financial intermediaries. Finance companies express this view

quite strongly. Some of the banks said that if it were not for the restrictions on interest rates and in taking mortgage security they thought they could cover much of the area. This was not the unanimous opinion.

MR. RASMINSKY: I think they said that without having the benefit of having seen the balance sheet and statement of some I.D.B. customers.

COMMISSIONER HARROLD: Is it not true that most applicants to the I.D.B. already have an obligation of some kind or another, and you have to work out the security?

MR. BEATTIE: Almost all of them have obligations to chartered banks for working capital loans. Indeed, we practically insist that they have chartered bank working capital credit of some kind.

COMMISSIONER HARROLD: I was thinking a little beyond that. In most instances they would not be starting with a clean sheet. They would already be into the lending business and would have some obligation in the financial field.

MR. BEATTIE: Many businesses that come to us are new businesses with a clean sheet, so to speak, or there may be a major expansion involved.

COMMISSIONER GIBSON: I would like to go a little more into the interest rate side of this. On page B-5 the brief says:

" The Bank does not take the position that any rate of interest in excess of

> "its own prevailing lending rate is
> for that reason to be regarded as
> unreasonable."

That is a very clear, negative statement. I wonder if you could give us a little more positive idea how much of a difference in interest rate makes a competing rate unreasonable? Do you look at the costs of the competing lender in relation to the rate that he is charging? How much of a difference in underwriting costs, or how high a difference in underwriting costs would there have to be for a medium-sized borrower before they are unreasonable? Would you comment on this?

MR. BEATTIE: Yes. First of all, I should like to indicate, again, there are very few cases, in our experience, which come down solely to a question of the alternative interest rate. Usually it is a question of reasonable terms and conditions, and is settled by other factors in the situation. Where it does come down to being a question of whether the interest rate quoted by the alternative lender is reasonable, we do tend to interpret the Act to mean that the going rate being charged by commercial lending organizations in com[illegible] unreasonable. It is impossible to be categorical in a field of this sort, and there are only a few cases where it comes down to this. But in general we do interpret "reasonable" to mean the going rates in the kind of lending business involved on applications of a

similar character to the one in question.

COMMISSIONER LEMAN: But if the business in question cannot earn the going rate, then it becomes unreasonable, is that it -- and can earn a somewhat lower rate?

MR. BEATTIE: In that case it might have been ruled out on that ground before it got to this stage; but, in fact, the interest rate remarkably seldom is the main factor. The term of the loan and the amount required for amortization of the loan -- the effect of that on the annual earnings of the business is much more important than the variation in the interest rate. The interest rate is seldom the major factor that makes a proposition impossible rather than possible, feasible rather than unfeasible for the business.

COMMISSIONER GIBSON: If the interest rate is not the major factor, and it is usually less important than the term, then why does not the I.D.B. charge an interest rate which is more or less in line with the going interest rate, because then this problem of rate competition would not stand out the way it does now. If you look at the table you have here in C-1, you will see there are a good many occasions when the I.D.B. charges less than the going rate for conventional mortgages -- not much less, but a bit less; and there have been occasions, though rare ones, only once, when they charged less than the N.H.A. maximum rate. Needless to say, they

charged notably less than finance companies' rates for some of the functions I speak of.

MR. RASMINSKY: I think, Mr. Gibson, one would have to say that the reason for this is that given the whole background of the establishment of the I.D.B. and its legislative history, and the type of discussion that took place when it was set up, the view that has been taken by the directors of the bank in fixing the rate from time to time has been that the rate should not be fixed at the levels that would be involved if the principle that you have just stated were to be followed.

It has been felt that it has been the desire of Parliament to provide the potential borrowers from I.D.B. with funds, in the appropriate cases, at rates, broadly speaking, of the type that have prevailed.

It would involve fewer problems of one sort if the rate were fixed in relation to the prevailing rates of what have been called competing lenders, and it might involve problems of quite a different sort, which might be more serious if the government-sponsored agency were to charge rates of the character that it would have to charge if that were the principle that was followed.

COMMISSIONER GIBSON: I see your point. It is just that if you charge a lower rate and then say that the rate is not a major consideration, they do not necessarily find this very convincing and you are in a difficult position to explain it, as you are in fact frequently charged with lending at a lower rate?

MR. RASMINSKY: That is right, it is undoubtedly the case that the I.D.B. rate is frequently lower than the rate that conventional lenders will charge for such loans as they would make to I.D.B. customers, but the determining factor in most I.D.B. decisions -- virtually all I.D.B. decisions -- to make loans at this rather favourable rate from the point of view of the customer is, as Mr. Beattie has indicated, not that the alternative rate that he would have to pay is too high, but that he could not afford to accept the loan on the alternative terms and conditions because it would place too great a strain on the flow of funds

that he could anticipate in the future from the earnings of his business and from depreciation.

COMMISSIONER BROWN: The I.D.B. is in a difficult spot because if they do not do enough they are critized from that point of view, and if they do too much, they are critized from the other point of view; but this other criticism comes from two types of sources; one is from competing lending institutions and the other criticism that I have heard voiced -- and this has come not from groups, but from individuals -- and that is criticism from competitors of the people to whom you have made loans. These are people who have borrowed money in the market, paid the going rate and are financing on that rate, and then a competitor, because he wasn't good enough to get that rate in the market, goes to the I.D.B. and gets a better rate, and so the inefficient person is getting a better rate than the person who is already operating in the market. This criticism has been voiced on many occasions to me. People find that competitors that are not as good and do not know as much about the business are getting a better [illegible] ready operating in a [illegible] the two classes as the efficient and the inefficient, Mr. Brown, and I wonder if that is ---

COMMISSIONER BROWN: It is probably overstating a point.

MR. RASMINSKY: I think perhaps it is a bit. I think the distinction tends, rather, to be

between these smaller ones and the larger ones.

COMMISSIONER BROWN: These are people of the same size which I am talking about.

MR. RASMINSKY: People of the same size, some of whom have access to I.D.B. credit?

COMMISSIONER BROWN: That is right.

MR. RASMINSKY: And some who do not?

COMMISSIONER BROWN: Who got their financing in the market and paid the going rate, and then these other people come along and get a better rate because they could not get the going rate.

MR. RASMINSKY: That is an anomalous situation, I quite agree. I think that the number of cases in which that would arise, the number of cases in which the I.D.B. would make a loan of a size -- and you will recall that we are talking of term loans, we are not talking of working capital loans -- the number of cases in which the I.D.B. would make a loan of the size which was economic for public financing, for financing through the market, must be very few, indeed.

COMMISSIONER BROWN: This wasn't financing through the market, but from one of these other sources that we talked about. Say that in most cases it depends on the term; in other words, the competing money is available at a higher rate of interest and for a shorter term. Well, a decision is made that because the term is not reasonable that it should be with I.D.B., but he not only gets advantage of the term, he also gets a lower rate than the market rate?

MR. RASMINSKY: Of course this could happen.

This is an anomalous situation, I agree, and it could happen also that an I.D.B. customer itself, that as an I.D.B. customer expanded and developed, and as his business prospered, that as he went out to face the cold world he might find that as result of his efforts, his success, he had to pay a bit more for his money than he had paid when he was being nurtured by I.D.B., and that is an anomalous situation, but I think that this possibility of such a paradoxical situation is really inherent in the Act. It is really inherent in the decision of Parliament to set up an agency which would provide special credit facilities to those who were not yet able to stand on their own feet.

COMMISSIONER BROWN: This anomaly is not only in making the credit available, which is one thing, but it is the second anomaly of making it available on better terms to people who cannot get it outside.

MR. RASMINSKY: Of course, on the face of it, ---- on better terms, ---- if you look only at the interest rate, but if you look at the whole credit picture, at the whole picture including the security which is obtained, the difference between the terms might be less striking than it appears to be by simply comparing interest rates.

COMMISSIONER BROWN: I would have thought it would have been the other way around; an interest rate comparison would add to the difference. In other words, getting an advantage both in interest rate and in term.

MR. RASMINSKY: And in the length of the

term?

COMMISSIONER BROWN: Yes.

MR. RASMINSKY: Yes, I think probably that in many cases that is right. I was referring to the amount of security that the I.D.B. is in a position to take under this Act, as compared to the amount of security that other lenders -- whether by law or by convention -- choose to take.

COMMISSIONER GIBSON: Well, on the matter of the term in the appropriate interest rate, how do you do this? I have puzzled over this table in C-1, and it doesn't seem to vary by any means consistently with the sort of market rates. Indeed, in 1957 and again in 1960 the rates go down relative to other rates, when other rates are going up, and it would be very interesting to know what the sort of thinking is in determining appropriate I.D.B. rates.

MR. BEATTIE: Well, I suppose there is a certain counter-cyclical pattern to the rate changes that you have referred to, Mr. Gibson. November of 1957 was a period when market rates were tending to go down. The rates charged by the other conventional lenders may go down more quickly or less quickly, or move less quickly or more quickly than the I.D.B.

[illegible]: You are suggesting here the I.D.B. gave a lead?

MR. BEATTIE: At that particular time it probably was giving a bit of a lead among the conventional lenders although I think not a lead to the bond market; the bond market had moved quite

substantially by that time.

COMMISSIONER GIBSON: A lead to the NHA rate, too?

MR. BEATTIE: Perhaps, but I think the general intention is one of some degree of counter-cyclical -- or cyclical, if you will -- movement within the broad framework that the President referred to.

COMMISSIONER GIBSON: Are these rates considered in relation to monetary policy at the time?

MR. RASMINSKY: I would not like to say there is really a very close connection between monetary policy and the I.D.B. lending rate. Generally, one of the considerations involved in fixing the I.D.B. lending rate is general credit conditions prevailing, and to that extent -- to the extent that they are influenced by monetary policy -- there is some connection, but I would not have regarded the I.D.B. as an instrument of monetary policy, as a way of making monetary policy effective in this sector.

COMMISSIONER GIBSON: But you wouldn't expect it to run contrary to monetary policy?

MR. RASMINSKY: No, I would not, Mr. Gibson. I would think that, as in small loans generally, the aim would be that these would be less subject to [illegible] change [illegible] monetary policy.

COMMISSIONER GIBSON: Both in terms of availability and interest rates?

MR. RASMINSKY: That is right, and I would apply that, as you know, to the small loans made by the commercial banking system as well as to the I.D.B.

loans.

COMMISSIONER LEMAN: Mr. Rasminsky, what did Parliament mean in the preamble of the Act that referred to the effectiveness of monetary action; what do they mean by that?

MR. RASMINSKY: Somebody else had better answer that?

MR. BEATTIE: I think the preamble is worded in a very general way and you have to try and make a general interpretation of it. I would not attach very much significance myself at this stage to that particular phrase.

Perhaps I might go back for a moment to my answer to Mr. Gibson's question. When I said that I thought I.D.B. tried to have in general a counter-cyclical interest rate policy, I should have added that I think this is so, not particularly from the point of view of the I.D.B. setting out to regulate the economy or to have a major economic influence, but just to keep in line with general movements in market rates which, of course, tend to be counter-cyclical, too, and the precise timing of changes may differ from the changes made by other conventional lenders; the I.D.B. may be earlier or later. To some extent this will depend on the timing of board meetings and that kind of thing.

COMMISSIONER GIBSON: If you look at the 1960 figure, for example, you will see in relation to 1959 the I.D.B. rate fell one-half and that the NHA rate went up three-quarters, and the conventional

mortgage loan rate went up one-half and the other two rates stayed the same, and this is really putting the I.D.B. rate in a very favourable competitive position, relatively speaking.

MR. BEATTIE: What this table doesn't show, unfortunately, is when the changes occurred in the other rates. The dates chosen are the ones when the I.D.B. rate was altered.

COMMISSIONER GIBSON: If you take September 1960 and October 1959 you find the I.D.B. rate is one per cent below the rate on conventional mortgages and a little over one-quarter below the NHA rate, whereas in 1959 it was the same as the rate on conventional mortgages and one per cent higher than the NHA rate, so there is a radical change in the relationship there over the period although, as you say, it does not show when the changes occurred.

MR. BEATTIE: Well, I think you have to make allowances for what you might call longer term trends in some of these rates. Trying to abstract from the cycle and look at the longer term trend, some seem to have been in an upward incline, and in that case you would not be so surprised to find the phenomenon [illegible] you have referred to,

The I.D.B. rate went up quite perceptibly from 1944 to 1952, whereas a number of the other conventional rates did not go up perceptibly during that time at all.

COMMISSIONER GIBSON: The mortgage rates did.

MR. BEATTIE: It got to a different level whereas the others, perhaps, adjusted themselves upwards on a long term basis later than the I.D.B. did, and that affected some of the cyclical comparison.

COMMISSIONER GIBSON: I think if you look at the table you will see the two market rates; the chartered banks' prime rate and the rate on conventional mortgages, and you pay much the same as the I.D.B. rate. In the shorter periods there are some quite marked variations as between them.

MR. BEATTIE: The increase in the I.D.B. rate occurred a bit earlier.

COMMISSIONER GIBSON: Yes, that is true; not earlier than the conventional mortgages, but much the same?

MR. BEATTIE: Yes.

COMMISSIONER GIBSON: I have just one or two other questions to ask about lending policy. I would like to ask you about the time of processing applications. On page B-2 there is this statement:

> "The Bank continues to try to shorten the time taken to process applications and has, on average, reduced this period appreciably in recent years."

Would you give us a rough idea of how long it takes on the average to bring an application to authorization?

MR. JAMES: Taking 1960 as the first year, 25 per cent of the applications were brought to the point of authorization and advice to the customer in 27 days.

COMMISSIONER GIBSON: That is from the date of the application?

MR. JAMES: From the date of the actual application.

COMMISSIONER GIBSON: Does that mean from the date of the initial request or the date of the formal written application?

[illegible] of the

COMMISSIONER GIBSON: Twenty-seven days?

MR. JAMES: Yes. In October, November and December of 1961 that had dropped to 22 days. That is, 25 per cent of the applications were authorized

within 22 days.

In the same period in 1962 that time was shortened to 21 days.

In fact, from 1960 to 1962 it went from 27 days down to 21 days, which is pretty much as fine as we can get it, taking the general average. Twenty-five per cent of the applications during the same period took as long as 67 days in 1960, 59 days in 1961 and 59 in 1962.

That is the basis of the statement in the submission.

COMMISSIONER GIBSON: Have you gone quite a way before a formal application is made? In other words, do the bank and the customer have a pretty fair idea of what is likely to be feasible by the time he makes his formal application?

MR. JAMES: Not very much. There might have been an interview or two, and a little exchange of correspondence. If at that time it does not look to be a hopeless kind of thing we then proceed to take the application and process it.

COMMISSIONER BROWN: What percentage would get turned down?

MR. JAMES: I would say about 20 to

25 per cent would get turned down at that stage.

COMMISSIONER LEMAN: Has that been the trend in the acceptance rate?

MR. JAMES: Exactly how do you mean, Mr. Leman?

COMMISSIONER LEMAN: With respect to the percentage that is turned down and the percentage that is accepted has there been a trend?

MR. JAMES: I do not think there has been any marked trend. If anything it has been leaning towards more authorization, but it is not very marked.

MR. RASMINSKY: I think that the recent revision of the Act, Mr. Leman, would have had an almost automatic effect in raising the ratio of acceptances to applications on account of the broadening of the field of eligibility. Some of the refusals or the turn-downs until 1961 would have contained a fairly high proportion that were turned down on the ground that they could not come under the Act.

MR. BEATTIE: In other words, the applicants were not eligible.

COMMISSIONER BROWN: This would be a decision that would be reached very quickly?

MR. RASMINSKY: Yes, this would be a decision that would be reached very quickly.

MR. JAMES: I was speaking of eligible applications.

COMMISSIONER MACKINTOSH: Mr. James was

speaking of rejections of formal applications, and not matters of information to an inquirer who was not eligible.

MR. JAMES: That is right.

COMMISSIONER LEMAN: Particularly in the more recent period of expansion of the bank with a large number of new branches being opened, et cetera, and your explanation on page F-2 to the effect that where you have no branches periodic visits are made by representatives from the nearest branch, how does the business come to the I.D.B.? Does the I.D.B. go after business, or does it wait until it comes to it?

MR. JAMES: A great deal of it is sent to us by the chartered banks, chartered accountants and lawyers, and so forth. The great preponderance does come in that way, but quite a surprising amount comes by word of mouth from people who are already borrowers.

MR. BEATTIE: The bank does feel it has some obligation to make its facilities known by a certain degree of advertising as well, and certainly [illegible] where we

spark an interest.

COMMISSIONER LEMAN: So, the other lenders -- the banks and other types of institution -- were not doing their job properly of sending to you people who required accommodation which they could not

give?

MR. BEATTIE: They may not have consulted anybody about their problems. Their ideas for expansion, or whatever it was they had in mind, might have been privy to themselves. They might not have consulted any outside financially sophisticated people at all, or even such people as their own auditors.

COMMISSIONER LEMAN: Are we going now from a fellow who tries to get accommodation on reasonable terms and who cannot get it and who perhaps can get it from the I.D.B. over to a fellow who never even thought he could get money at all and who did not even have an idea?

MR. BEATTIE: Well, his plans ---

THE CHAIRMAN: Someone who did not have an idea that there was money lying around.

MR. BEATTIE: He may have had an idea as to something he wanted to do, but he may have been defeatist about the possibility of getting financing for it until he came into contact with someone or something that caused him to inquire of the I.D.B.

[illegible] A little earlier, [illegible] might develop, some inverse correlation between the availability of funds in certain areas and the rate of activity of the I.D.B. in that area. You said that there would be an inverse ratio as between

the availability of capital and the rate of activity of the I.D.B. Did I understand this clearly, that in areas where less funds would be available through the private sector it would follow that the I.D.B. would be a little more active? Is that what you told Mr. Gibson earlier?

MR. BEATTIE: Yes, in a sense that is so, although in areas where financing is somewhat less readily available you sometimes find that the rate of putting forward proposals is a little bit less, too.

In other words, the formulation of proposals for expansion and for the use of the particular kinds of financing that the I.D.B. can provide may lag a little bit as well. What I did say was that in such areas we work even harder than we do elsewhere to make our existence known and to make our facilities known, and where propositions are brought to us to try to work them out to the point where something can be done. Very often the original proposition put up by an applicant is not feasible for one reason or another, but if you work away at it you may be able to find a basis for a loan.

COMMISSIONER LEMAN: These areas are not very well defined geographically because at page D-4

you show us that the real correlation has turned out to be with the employment and economic activity of the various regions of Canada. Therefore, the implication would seem to be as to availability that there may not be much difference.

MR. BEATTIE: This could reflect the degree to which we work a little harder, I suppose. Actually, one factor that is not mentioned there is the gross regional product. What is mentioned is employment and the capital investment intentions.

COMMISSIONER LEMAN: But that is a close correlation, is it not?

MR. BEATTIE: Yes, there is a surprisingly close correlation.

THE CHAIRMAN: We will adjourn for fifteen minutes.

--- Recess.

THE CHAIRMAN: The Commissinn will now resume.

COMMISSIONER GIBSON: I have a couple of further questions to ask with regard to lending policies. We have heard a few complaints to the effect that the I.D.B. tends to take all the security which makes it difficult for the other lenders. This is a natural enough complaint, but I am wondering whether it has substance. I am wondering what your standards are with respect to the taking of securities. Do you endeavour to take a mortgage on all of the fixed assets pretty

well regardless of the size of the loan, or do you have some relationships in mind as to the amount of coverage in relation to the amount of the fixed book assets?

MR. BEATTIE: One usually starts off with a situation in which the business needs to borrow as much as it can for whatever project it has in mind, or to get it over a difficult period, or whatever it is. In the interests of making the largest loan that can safely be made, one naturally looks to see what various kinds of security can be offered, as well as making the best appraisal you can of the capacity of the business to generate funds for repayment. The reason why people may feel that the security taken is excessive is that the bank has been trying very hard to make the maximum amount of loan it can.

COMMISSIONER GIBSON: What about the situation where a loan is getting pretty well paid off? Do you keep your full security until the end of the loan?

MR. JAMES: Not necessarily. We have very often released security, perhaps at the request of the borrower because he wants to make another loan outside. For instance, with respect to a chattel mortgage we have often released the assets when the loan was getting down, and we were satisfied that the business was on its way and was doing reasonably well, and so forth.

MR. BEATTIE: We/drop guarantees.
may

MR. JAMES: Yes, on many occasions we have released guarantors, and that sort of thing.

COMMISSIONER BROWN: You mentioned doing this when the borrower wants to go outside. At what stage do you push him out? Take as an example somebody you have financed and who has made progress, and he then wants to expand further so he comes to you, presumably, to see if he can get his loan up again. At this stage do you force him to go through the whole process again of trying to face the market to see if he can go outside?

MR. JAMES: Sometimes, and there have been a couple of cases this year in which they have gone outside to the market at our suggestion.

COMMISSIONER BROWN: Do you go through this test of reasonable terms and conditions again?

MR. JAMES: Yes.

COMMISSIONER BROWN: In all cases?

MR. JAMES: I would not say in all cases, but in most cases. Where they have a chance of reaching the stage of viability and so forth, and if they can go outside to the market, then we do encourage them to do so.

MR. RASMINSKY: I think any application for an I.D.B. loan [illegible] loan or an increase in an existing loan, has to meet the test of the unavailability of funds elsewhere under reasonable terms and conditions.

COMMISSIONER BROWN: I gather that in some cases you make a decision on whether this is

likely to be possible or not?

MR. JAMES: Yes, I would say we very often do.

COMMISSIONER BROWN: I am wondering whether as a matter of policy you send them outside, or whether you do at times just increase the amount of the loan.

MR. RASMINSKY: Where it seems to us that there is any possibility at all that the money could be raised from a conventional lender then we would require evidence in respect to a second loan of the same character as we would require in respect of a first loan, namely, that an approach has been made to a conventional lender and the applicant has been turned down.

COMMISSIONER BROWN: On this question of further loans I notice that last year there were 250 customers whom you permitted to defer some payments of some kind. Do you ever increase a loan under those circumstances, or do you only increase a loan when somebody is meeting his present commitments, or is there no standard rule on it?

MR. BEATTIE: In some cases we would even increase the loan. The more normal procedure is to defer the repayment schedule if it seems justifiable.

COMMISSIONER BROWN: But on occasion you will give them more money to carry out further expansion even though they are not meeting their present commitments?

MR. BEATTIE: I think on occasion that has been done, if we feel the basic situation is sound.

MR. RASMINSKY: Just to underline the reply that you have received, Mr. Brown, the bank is opposed to the policy of throwing good money after bad. If the deferment of a loan is an indication of a basic weakness in the situation, then the bank would not increase the loan. If the deferment of the loan is necessary, or seems desirable because there is some new program of expansion under way which shows promise of success, then we could have the combination of a deferment on the existing obligation and an increase in the bank's commitment to the business.

COMMISSIONER BROWN: The fact that there was a deferment would lead to the assumption that they could not go out to the market?

MR. RASMINSKY: That would be some <u>prima facie</u> evidence of that, yes.

COMMISSIONER GIBSON: I have one other question to ask with respect to lending policy. You state at page B-11 in the middle paragraph:

" The I.D.B.'s practice is to set

payments in such a way that the borrower will have some opportunity to benefit from the programme being financed with the I.D.B.'s help."

Just prior to that you say that the period between the

date of authorization of a loan and the date of commencement of repayment was, in the fiscal year 1952, 4.9 months. To me this does not sound very consistent. It seems hard to believe that in 4.9 months the borrower will have had the opportunity of benefiting from the program that has been financed with I.D.B.'s help. This is not a major point, but he may not have fully drawn down the money by that time, let alone put a substantial capital program into operation.

MR. BEATTIE: This is an average, Mr. Gibson. There are many cases in which the period is longer, and there are some in which it is shorter.

COMMISSIONER GIBSON: This produces pretty quick results.

MR. BEATTIE: I suppose you could put it this way, that five months is better than four months or three months. Very often in contracts of this sort the repayments begin immediately -- on real estate mortgages, for instance.

COMMISSIONER GIBSON: You are stating here a concept that is known in another quarter that the repayments should come out of the revenues from the improvement, to some extent, and in most cases the improvement would not be producing any revenues in this period. It would not be completed.

MR. BEATTIE: The final aspect of the program, of course, may be very nearly complete by the time the loan is authorized. Very frequently loans are reimbursing working capital that has been

paid out for capital expenditures that have been made.

MR. JAMES: As Mr. Beattie expressed, this is only an average period. We have quite a few loans on which repayments do not start for a year.

COMMISSIONER GIBSON: Yes, but some are starting sooner than that.

MR. JAMES: Yes, and very often, as Mr. Beattie said, a man will come to us when his program is well advanced. He had been hoping to get the money elsewhere and then found that he could not do so, and then he came to us when his plans were well on the way to completion, and that is before the financing is arranged.

COMMISSIONER BROWN: In those cases, what would happen if you did not approve the loan?

MR. JAMES: He might be in very serious trouble if he had gone too far.

COMMISSIONER BROWN: That would probably be *prima facie* evidence that he is not a very good businessman.

MR. JAMES: That may be the case, but other things may enter into it. He may have been selling a piece of property which he later found he could not dispose of. He may have had some machinery to sell and he went ahead confident that he could sell it, and then found out for various reasons that he could not sell it and he was then short in financing his program. There is an extra-

ordinary number of combinations of such things that we run across.

COMMISSIONER LEMAN: Going back to a section which Mr. Gibson referred to earlier, subsection 8 on page B-8, Mr. Gibson asked you if the I.D.B. had been used on occasion to prevent ownership passing to non-residents. You also imply there that the I.D.B. might step in in a case where there might be financing difficulties in connection with estate taxes. Has this happened?

MR. JAMES: We have not actually had a case yet. We have had discussions with two or three people who were anticipating the impact of death taxes, but we have not actually concluded any particular case with anybody.

MR. RASMINSKY: I think, Mr. Leman, I am right in saying that the reason both these possible uses of I.D.B. funds are referred to in the submission is that they were mentioned by the Minister of Finance in introducing the amendment to the Industrial Development Bank Act which enlarged the field of eligibility in June, 1961. They are not mentioned on the basis of any recent experience.

COMMISSIONER LEMAN: No, this is too new to have been tested fully. This case rather amused me. It leads to a rather strange sort of a situation. If the basic approach of the I.D.B. is still that it should lend only to those who cannot reasonably be accommodated elsewhere, if the I.D.B. were to step in in a case where the estate taxes are the difficulty, it would sort of lead to the kind of a situation that a person would borrow from the Crown to pay to the Crown taxes which

are so heavy that their payment cannot reasonably be financed privately.

MR. RASMINSKY: The next step would be to make payment on the succession duties in the form of the stock of the company.

MR. BEATTIE: The purpose is to avoid the business having to change ownership and perhaps get into less experienced hands in the process of this shuffling around.

COMMISSIONER LEMAN: I would have thought that if the estate taxes on a business were heavy it must be because that business is quite a valuable one, and normally one would expect that it could finance in the market. However, I do not want to make too much of this. I just thought it would be amusing to imagine what would happen.

MR. RASMINSKY: I think it is related to the problems of relatively small family businesses which either would have difficulty in financing publicly or would lose control and perhaps, in losing control, lose along with it the management of the business if they did finance publicly. The thought was expressed at the time the last amendment was introduced that the Industrial Development Bank might be of some help in enabling people to retain control and ownership of their business and yet put themselves into funds to pay their just debts to the government.

MR. BEATTIE: The submission also mentioned that this might be done in contemplation of a situation where estate taxes would have to be paid. In other words,

it might be a case of the business getting its finances in better order in advance of the event.

COMMISSIONER LEMAN: Going back to interest rates for a minute, could you tell us basically what is the reason why the I.D.B. feels that the rate ought to be pretty standard? You explain that in some cases a higher interest rate might be charged but that in general you use a standard rate for small loans, bigger loans and loans which are more expensive to investigate and appraise. Why is this? Why not have quite a variety?

MR. BEATTIE: A variable rate?

COMMISSIONER LEMAN: Yes.

MR. BEATTIE: Well, the practical complications of having a series of different rates is quite a considerable one. The boundary lines between the different rates would be extremely difficult to deal with as a practical matter. How and where, precisely, would one draw the lines? People just beyond one of these lines might feel unjustly dealt with.

MR. RASMINSKY: I suppose that a real difficulty here, Mr. Leman, is that if one was to set up a rate schedule on the basis of cost or profitability to the I.D.B. of various types of loans, the smaller loans should attract the highest rates because the costs in connection with the smaller loans as a portion of the total amount are the highest. I think that it has been felt there are difficulties of acceptance and also that it would be contrary to the

original idea of the I.D.B., which was to provide some special encouragement to small business, for the institution to have a rate schedule which involved charging more in the case of small borrowers than in the case of large borrowers.

COMMISSIONER LEMAN: But the Act implies that the activities of the I.D.B. should be self-sustaining and often lead to a certain amount of profit, but you interpret this as meaning on average, that you might have some loans which in fact might be a losing proposition?

MR. RASMINSKY: Oh, yes indeed, Mr. Leman. I think it must be the case that on a straight economic calculus that quite a large proportion of the loans made by the I.D.B. are unprofitable, are not loans which would be undertaken by a lender who was in business to make a profit.

COMMISSIONER LEMAN: So that those others who can give the I.D.B. a profitable business can be said in a sense to pay for those who do not?

MR. RASMINSKY: Yes, although the pain may be mitigated by the fact that they in turn may be getting their money at a rate which is more favourable to them

were able to get

COMMISSIONER MACKINTOSH: I have a few questions on section E of your brief where you speak of equity financing, underwriting and guarantees. You state in the third paragraph on that page that the very limited amount of equity financing you have done

would be explained largely in the marked unwillingness of shareholders in a small business to dilute their equity or to give up in some measure their control. If you cannot make some capital gains, so to speak, on your highly successful cases, and if further you feel your interest rates have to be moderate and not run too high, then on some of the pretty risky projects you take on, this failure to use equity financing considerably reduces the profitability or the range of profits of the institution.

To the degree that you are a lender of last resort you should be able to overcome a good deal of unwillingness on the part of the borrower. To what extent has this equity financing been pushed?

MR. BEATTIE: In particular cases I think the possibility has been put forward quite strongly, but it has also been resisted quite strongly. In a great many cases we would face a situation where the [illegible] ion than give

[illegible] non-voting stock or something of [illegible] kind eliminate the question of control?

MR. BEATTIE: I do not think we would ever contemplate voting the stock in a very active way in the few cases where we do get it.

MR. RASMINSKY: I should think a greater obstacle, Dr. Mackintosh, is the fact that the capitalization of money of the companies that the I.D.B. does business with provides really very little in the way of

shareholders' capital. A very small amount of money is characteristically put in the business in that form. The I.D.B. does, of course, have a great interest in the amount of equity capital, in the amount of the principal's money, the shareholder's investment in the business, but quite often the shareholder's investment takes the form not of the issue of capital stock but of shareholders' loans to the company, or the earned surplus end of the company.

Quite often you would find a fairly nominal amount of share capital, $5,000 or $10,000 in the small or medium-size businesses, and the opportunity for the I.D.B. to make any substantial amount of money available in that form is, I think, often limited for that reason.

COMMISSIONER MACKINTOSH: What is the explanation for the very contrasting pattern of the Industrial and Commercial Financial Corporation in Great Britain, which I think has about 40 per cent in equities?

MR. JAMES: They do not have such a small range as we do. I think their range is a 5,000 pound minimum loan and a 200,000 maximum loan, and particularly in the early days they did a tremendous amount of business by straight equities or preferred shares and that sort of thing, rather than straight mortgage financing as we concentrated on.

MR. RASMINSKY: What is their average loan?

MR. BEATTIE: Their average loan would very much greater than ours. It is about 60,000 pounds or $200,000.

MR. RASMINSKY: As compared with $180,000 in

our case. Incidentially, the figure Mr. Beattie has given is not the average loan of the Industrial and Commercial Financial Corporation but it is their average participation. Is that right?

MR. BEATTIE: Yes, the average amount outstanding.

MR. RASMINSKY: They are dealing with bigger customers than we are.

MR. BEATTIE: They are not quite so limited to the residual role either.

MR. JAMES: No, definitely not.

MR. BEATTIE: Because there is a substantial element of private ownership there.

MR. JAMES: Yes.

COMMISSIONER GIBSON: Bearing that in mind, is there anything to prevent the Industrial Development Bank from taking a capital interest in a private lending institution like the I.C.F.C.?

MR. RASMINSKY: I do not believe there would be anything in our Act that would prevent the I.D.B. from doing that. However, there would be some reluctance on the part of the I.D.B., which is a government-sponsored organization, to become a shareholder in one of a number of competing private institutions. I should have thought that

conventional private lending institutions is a joint venture relationship where the private institution puts up part of the money and perhaps takes security of a certain type, and the I.D.B. puts up some money too and takes another type of security. I think there is more

promise in this than there is in the I.D.B. becoming a partner with one of several competing institutions.

COMMISSIONER GIBSON: Both Mr. Beattie and Mr. James suggested that the scope of the I.C.F.C. was somewhat broader, and the thought occurred to me that this would be a way of filling a gap which is beyond your present range of activities.

MR. RASMINSKY: Yes.

COMMISSIONER MACKINTOSH: I would think that in a number of these cases the simplest fact is that what they really need is more equity capital in the enterprise. They tend to exhaust all their borrowing potential and still need more to make a go of it.

MR. RASMINSKY: I think that is true, Dr. Mackintosh. In many cases the companies that we see are under-capitalized. The other side of it, of course, is that if the relationship of the Industrial Development Bank to these enterprises was that of a risk-taker, if our investment had to take the form largely of equity without the security that we get, in the way we characteristically do business now, then so long as we are operating on the basis that we expect to get our money back, I would not be certain that we would be able to do business on the scale that we are presently able to do it.

COMMISSIONER MACKINTOSH: Well, of course, I was not assuming that this become your main business at all. From what you said I had gathered it has been a rather small and not a very promising part of your operations. Has the Bank combined its continuing

interest in an enterprise as the chief lender with continuing management-counselling services of that sort?

MR. JAMES: We have always taken the view, Dr. Mackintosh, that we are not in the management consulting business, and we have usually avoided giving direct advice, as such, to borrowers. We have felt, for example, that this would tend to infringe upon the activities, on the recognized business activities carried on by competent business advisors, such as accounting firms, and so forth. We have also felt it could easily alienate the goodwill and co-operation of management consulting enterprises. There is a particularly fine line as to where we would be impinging, on the question of fields.

On the other hand, the discussions that have been carried on with an applicant and the engineering investigation we do undertake, we have been told by many applicants, are quite beneficial to them and will occasionally lead an applicant to make refinements or modification to his plans for the project or method of operation for the existing plant. It would be extremely rare for the bank to stipulate specific changes for any loan advanced.

customer. Many do come in and sit down with our engineering and technical staff and discuss the problems, and we try to be helpful, in that sense of the word, and I think we have been on a number of occasions.

COMMISSIONER MACKINTOSH: Many institutions, perhaps mainly private, who are engaged in this kind of business, building up small firms, do combine lending with a continuing counselling service, with varying degrees of voluntariness. I imagine the enterprises whom you assist by your loans have varying degrees of experience, and that an expansion very frequently forces them into a field where their experience is not as great as one might hope it would become. You spoke earlier about the use of your powers of guarantee. This has been more substantial than equity financing, I take it -- or has it?

MR. RASMINSKY: Yes, it has. There have been more cases where we have given guarantees than cases where we have participated in equity.

COMMISSIONER MACKINTOSH: What are the possibilities of spreading your financial resources further, by using this more frequently and letting them get their money under your guarantee? Are there many opportunities where a similar rate of interest would be obtained by that method?

MR. RASMINSKY: I think the answer to that question must be "no", Dr. Mackintosh, because we would have to charge for the use of our guarantee, [illegible] lar, then the other lenders' rates of interest would have to be less than the I.D.B. rate, and if it is less than the I.D.B. rate nobody would come to us; we would not get the business.

This does not, of course, answer your

basic question, as to whether there might, nonetheless, be a greater scope for the use of guarantees rather than direct lending of the type we do. Would you like to say something about that, Mr. James?

MR. JAMES: I do not know that there has been any great scope yet for a guarantee. In many of the cases we have done to date, it has been a sort of emergency kind of operation to keep a business going when, perhaps, its chartered bank has tended to cut down. We have stepped in with a guarantee, to keep it going, to see whether we could bring out some feasible plan for survival or to get the particular company over its difficulty.

COMMISSIONER MACKINTOSH: As an instrument of new, you might say, initial financing, I gather the guarantee is of very little consequence?

MR. JAMES: I would not think there would be any great possibilities in that, Dr. Mackintosh. It is also a fact, as Mr. Rasminsky mentioned before, that these companies that do need our guarantee, if they borrow from a chartered bank they are certainly not going to get the prime rate but are going to pay a higher rate, and we have to put in a reasonable charge for our guarantee, and it mak[illegible] borrower.

COMMISSIONER MACKINTOSH: I see in your brief that your power to participate in underwriting agreements has only been used once, and you do not see much possibility of enlargement there.

MR. RASMINSKY: I am hesitating over the

last inference that you draw, because the one possibility which we took advantage of was a very interesting case, and I would like to think that we would be able to develop, or that there was a real scope here for the developing of I.D.B. activities through participating in underwritings.

Of course, even our participation in an underwriting would have to be subject to the overriding condition that it was necessary in order to obtain reasonable terms and conditions. It would not be regarded by us as proper, under the statute, to participate in an underwriting merely for the purpose of making the underwriting easier, to leave less of the stock to be distributed to the public, or less of the debentures to be distributed to the public. Of course, that limits the extent to which we can participate.

The one case, and it is a recent one, in which we did participate was one where this condition seemed to be met. It seemed to be the I.D.B. willingness to participate that made the

ed out

that we had investigated

it pretty thoroughly ourselves, and it looked good enough from our point of view to participate was encouraging to the main underwriters. For one reason or another we were able to convince ourselves this would not have gone ahead without I.D.B. parti-

cipation. And if any similar cases to that come up in the future, I think it is a good technique and I would like to see it developed. The fact we did participate in this case is known to the investment fraternity.

COMMISSIONER MACKINTOSH: How do you find out whether the investment people would be willing to undertake an underwriting? Do you have to canvass them all?

MR. BEATTIE: The specific fact of our willingness to occupy this role in respect of an underwriting which could not be made without our participation was known to a number of investment dealers, typically those who engage in this kind of smaller business underwriting project. As the President has said, now that we have a case on the books and have referred to it in the submission, presumably everybody who is interested in it knows and they are in a position to bring forward propositions if they have propositions of this kind. But I think this will probably always be a rather narrow field, the kind of proposition that cannot get by on its own but can get by with the participation of the I.D.B. We are very interested to hear about them and are willing to participate, but I would not think there would ever be a great volume.

COMMISSIONER LEMAN: Who developed the good idea at that time?

MR. RASMINSKY: Mr. Beattie.

MR. BEATTIE: The fellow who developed the idea was the fellow looking for the accommodation.

THE CHAIRMAN: Perhaps he thought the presence of the word "bank" in the name of your organization would be so attractive.

MR. BEATTIE: He eventually heard about the Industrial Development Bank and came to see us. The initiative came from him.

COMMISSIONER MACKINTOSH: He was wanting to float an issue and was having difficulties with it, and eventually came to you to see if you could make the thing go?

MR. BEATTIE: He had applied to us for a loan, and we had made a considerable investigation of his affairs, so that we knew a good deal about his situation before the proposition of a joint underwriting participation came up.

COMMISSIONER MacKEEN: The dealer would look after all the distribution of the underwriting, I presume?

MR. BEATTIE: Yes, all we did was to undertake to subscribe to a certain moderate proportion of it.

COMMISSIONER MacKEEN: Had it not gone well, you would have been left with them?

MR. BEATTIE: Yes, definitely.

COMMISSIONER BROWN: Were you left with any?

MR. BEATTIE: We did not carry it through to the end of the fiscal year. The market

turned out to be good.

MR. JAMES: It was about ten days.

COMMISSIONER LEMAN: Did you get your share of the underwriters' remuneration, et cetera? Were you an underwriter in the true sense of the word?

MR. BEATTIE: I cannot remember the exact details of that, but there would have been a participation fee as well as some part of the ordinary underwriting return.

COMMISSIONER LEMAN: How big was this operation?

MR. BEATTIE: The amount of our participation was quite moderate.

MR. JAMES: It was a $1 million issue, and we undertook to pick up, if necessary, 30 per cent, $300,000.

MR. BEATTIE: We did not have to pick up that amount.

MR. JAMES: It was under $50,000 we picked up.

COMMISSIONER BROWN: I would like to ask a number of questions on equities, going back just a little. First of all, on page E-2 you refer to the fact that:

"In eighteen years the Bank has acquired a stock interest in only 23 companies; common shares were involved in the case of 16 companies, preferred in 4 and a combination of

"common and preferred in 3. The Bank presently has an equity interest in 8 companies."

In Table 3 the footnote refers to the profit on sale of equities relating to three customer accounts. What happened to the rest?

MR. BEATTIE: These were the ones in which there was a substantial profit.

COMMISSIONER BROWN: You had a profit in three, and have still an interest in eight?

MR. BEATTIE: We would get our money out on the others.

MR. JAMES: We have disposed of the others as we have gone along. In the case of one particular issue on which we had about 10 per cent of the common stock, with our encouragement the thing went out on the market and we got rid of our shares that way. In a couple of cases the original principals of the company have come back and made us an offer for them, and we have disposed of them to them; they have repurchased them. But actually they have mostly now gone out in various ways.

COMMISSIONER BROWN: You have eight now?

MR. JAMES: Yes -- the difference being the fifteen that have gone out.

COMMISSIONER BROWN: Did the others go out as a loss?

MR. JAMES: No, there has been a modest profit on them in / total, but in a couple of cases where we did have stock in a very minor proportion the company

has gone out of existence and we did not get anything, but there has been no real loss as such.

MR. BEATTIE: In three cases we made a substantial profit.

COMMISSIONER BROWN: There were other cases in which you made a modest profit?

MR. JAMES: Yes, a modest profit.

COMMISSIONER BROWN: When you do take an equity position do you pay for it, or is this by way of bonus?

MR. JAMES: We pay for them all.

COMMISSIONER BROWN: You have paid for them all?

MR. JAMES: Yes. In the very early days we took one or two on a bonus, but we did not think this was a very good idea and we have got down to where we pay usually the same price as the other people pay.

COMMISSIONER BROWN: When you do take an equity position, does the owner have the right to repurchase at a higher price?

MR. RASMINSKY: In all cases the owner has the right of first refusal of the equity. We would not sell it to a third party without offering it to him first.

COMMISSIONER BROWN: Does he have the right to repurchase?

MR. JAMES: There is a very recent case in which we have done that, but we would normally give them the first refusal, as the President says.

COMMISSIONER BROWN: When you say "normally" what do you mean?

MR. BEATTIE: Invariably.

MR. JAMES: "Invariably", perhaps, is the better way of expressing it. We give them the right of first refusal invariably.

COMMISSIONER BROWN: Mr. Rasminsky made mention of the fact that in many cases the equity base is very narrow. In fact, one of our witnesses -- I think the Laurentide Finance Corporation -- suggested this meant that, in effect, in many instances the I.D.B. was either putting up equity or a portion of what the I.D.B. was putting up was, in effect, an equity; and on a fair basis, therefore, the interest on this loan was not an interest on a loan but really a dividend on the equity and should not be permitted as a charge for income tax purposes.

MR. RASMINSKY: I think that in saying that they must have had in mind equity in a narrow, technical sense of shareholders' capital.

COMMISSIONER BROWN: No, I think that they had it in mind in a sense of a proportion of the whole, that such a large proportion of the whole was being put up as a fixed income security; that this was out of proportion to the equity that would normally be expected in a firm of the size involved.

MR. RASMINSKY: Well, I suppose different lenders would apply different standards to that. We certainly, in looking at any loan, are concerned with the amount of the shareholders' capital in one form or another that there is in a business, and we would be reluctant to make a loan without a great deal of shareholders' capital in ahead of us.

COMMISSIONER BROWN: Behind you.

MR. RASMINSKY: Behind us, yes.

COMMISSIONER BROWN: Have you a minimum ratio beyond which you will not go?

MR. RASMINSKY: No, we haven't.

COMMISSIONER BROWN: Well, could I ask what is the farthest you have gone?

MR. BEATTIE: I don't think we could answer that without having a careful look at the records.

COMMISSIONER BROWN: I would have thought you had some rule of thumb beyond which you would not go?

MR. BEATTIE: We have often made loans which exceeded in amount the shareholders' investment.

COMMISSIONER BROWN: Do you go beyond 80 per cent of the whole?

MR. BEATTIE: From memory I would say not.

MR. RASMINSKY: I would say, Mr. Brown, without having any rule of thumb, as Mr. Beattie says, we have often made loans and our participation, our contribution, has been greater than the current investment of the shareholder. When it gets to a point where we seem to be having more money in the business

than the shareholder, we look particularly hard at the application.

COMMISSIONER BROWN: In other words, you look particularly hard when it gets above the 50 per cent?

MR. RASMINSKY: Yes, using the term "shareholders' investment" in the broad sense.

COMMISSIONER BROWN: The total equity of invested capital plus ---

MR. JAMES: Shareholders' loans.

COMMISSIONER BROWN: The surplus plus the loan?

MR. JAMES: Yes.

COMMISSIONER LEMAN: You must have looked particularly hard, then, because on B-6 there the total shows what the financing of customers' programs was in fiscal 1962.

MR. RASMINSKY: These figures on B-6 relate to the additional programs; these do not indicate the amount of money that is already in the business.

COMMISSIONER LEMAN: It is not the end position?

MR. RASMINSKY: It is not the end position, no sir.

COMMISSIONER BROWN: If there are no more questions on this particular point, I have a few questions on financing, and I understand that one of the problems that is involved is that you have very expensive investigation costs, and to a degree there is an acceptance of a subsidy to assist small business. I wondered if you had any objective to which

you worked?

Perhaps I should make my point a little more clear. If you look at table 3 you see the net profits which accrue each year, and I have worked out some figures -- not only using table 3, but a couple of other tables because I tried to work out the net profits on equity of the I.D.B., which means the equity of the Bank of Canada in the I.D.B., and I have worked them out on the basis of the equity consisting of capital plus reserve funds, and the percentage of profits before any write-offs for losses or provision for losses, and running backwards from 1962 it worked out at 2.3 percent, 4 percent, 5 percent, 5.9 percent, 5 percent, 4.5 percent, 4.5 percent, 3.7 percent and then 5.9 percent in 1954, and, of course, the profits after the write-offs for actual losses are less than those. The only years in which the profits before any write-offs were 5 percent or greater were the years in which you had capital gains from the sale of the equities.

What I am leading up to is this; these figures are all before income taxes -- because you are not paying any income taxes -- and one of the things which has been before this Commission is to try and look at this gap that apparently exists in the financing of small businesses to see if there is any way of encouraging private enterprise to fill this gap.

On the basis of these figures it would appear that certainly on the rate of interest that you are charging it would be impossible to encourage anybody to fill this gap. I am wondering what sort of objective you had, in looking at your profit picture, if you charged a rate of interest which was more in line with the market rate -- which was what we discussed earlier -- obviously the figures would be slightly better, but it seems to me in all this there is a very considerable subsidy, not only in making money available to businesses who cannot find it elsewhere on reasonable terms and conditions, but that all the terms and conditions under which you are providing it -- and this is including this cost of investigation -- are considerably better than you would expect a market to face.

MR. BEATTIE: The main factor in the phenomenon which you are referring to, Mr. Brown, I think is the preponderance of quite small loans in the I.D.B. business. It has been referred to several times this morning that the cost of these loans, including investigation and supervision, probably had exceeded the income that the I.D.B. makes from them, but the I.D.B. is enjoined to pay particular attention to this kind of loan in the original Act, and this is emphasized in the preamble to the Act.

I think the whole concept of the I.D.B. was based on a view that it was not intended to earn large profits. you can deduce that from the fact the dividend rate is limited, if and when dividends are paid, and also there is the provision

for establishing quite a large reserve fund before any dividends can be paid, which would cover losses and keep down the rate of return on capital and, of course, there was no provision for income tax being payable under the Act.

THE CHAIRMAN: Well, is there another aspect to this? There is the very steep increase in business done following the year 1956 or 1955?

MR. BEATTIE: Yes.

THE CHAIRMAN: You would hardly expect that in those few years that profit would appear to increase very rapidly?

MR. BEATTIE: The increase in expenses inevitably preceded the increase in income.

THE CHAIRMAN: There is a very great increase in investment, and during that period there has not been time to determine how profitable the enterprise might be. Would that have something to do with the decline that is noticeable in these figures on the profit level over that period, because it seems to me you start at the beginning of the profit figures and there seems to be a gradual increase for a number of years, more or less,and then it begins to taper off during this period when the investment was very high, relatively, to what it had been before?

MR. BEATTIE: This is particularly true in the last three years, and even more particularly of the last two, following the expansion in the field of eligibility and the great increase in the number of new loans and, of course, the expense of investigating

and putting loans on the books precedes by quite a long period the return you get by way of interest on them.

THE CHAIRMAN: Then also you were experimenting in loans of a somewhat different class during that period; you were branching out a little bit.

MR. BEATTIE: Well, we had taken on a new field of eligibility, but all through the history of I.D.B. there has been on a moderate scale a process of experimentation going on, seeing just how far it could go in these various fields in making loans and still pay its way. There has been all through its existence a gradual pushing back of the boundaries in terms of risk of the fields that it feels it can occupy.

COMMISSIONER BROWN: In the first place, if you go back a few more years the rate is lower still.

MR. BEATTIE: I think this phenomenon relates generally to the last three years; the impact on the rate of return of a very rapid increase in the amount of business done.

MR. RASMINSKY: I think that the point made by Mr. Brown remains a valid point. There is a special explanation for the decline in profits during the last couple of years, the one which the Chairman referred to; the build-up of staff and the opening of new branches, before an income is derived from the amount of new businesses that has been placed on the books.

Even if one forgets about the last couple of years, I think the point made by Mr. Brown is that the rate of return on this business, handled the way the I.D.B. has handled it -- that is, charging the rate of

interest the I.D.B. charged -- the rate of return on this business has not been such as to be attractive to a private enterprise.

COMMISSIONER BROWN: Because the figure I was giving you was before any loss whatsoever.

COMMISSIONER GIBSON: Another factor in your recent lack of profitability has been a marked increase in the cost of money, and it would be a greater increase than the increase in the rates you charged.

MR. RASMINSKY: I thought I would leave it to you to mention that!

COMMISSIONER BROWN: On the face of it it seems difficult to see how any competing body could hope to make money at the same rates of interest that you were charging.

MR. RASMINSKY: Handling the same types of loans?

COMMISSIONER BROWN: Yes?

MR. RASMINSKY: Yes, handling the same types of loans.

COMMISSIONER BROWN: This all comes back to a discussion of what are "reasonable terms and conditions".

MR. RASMINSKY: I think it includes in the discussion, Mr. Brown, the consideration of what type of loans shall be handled. We pointed out several times here that the profitability of the bank has been very much influenced by the fact that the average size of the loan has been low; the majority of the loans have been for amounts of under $25,000.

COMMISSIONER BROWN: Well now, have you got

or do you carry out a calculation to show, for your own purposes, what sort of subsidy you are in fact giving because of this cost of investigation?

MR. RASMINSKY: Well, ---

COMMISSIONER BROWN: I am not asking, I am just wondering whether this is considered in your operation, in special interest rates and all the rest of it?

MR. RASMINSKY:

No, we have not done a systematic cost accounting of these various types of loans, although we think we do have some ideas which are based on experience, and extending over some time, as to the level at which a loan is likely to yield a profit, or the cost of putting it on our books.

COMMISSIONER MACKINTOSH: If I could interject, the fact that a private firm couldn't take over, would have no inducement to take over the operation of the I.D.B., does not mean that they couldn't here and there skim a little cream off this 2 per cent milk that is your business, so to speak. There is a margin where I would think some business might be nearly competitive, but certainly the operation is quite unattractive.

COMMISSIONER GIBSON: Following Mr. Brown's line of questioning, there is an element -- whether you want to call it subsidy or unprofitability, it doesn't matter -- in your activities. What I am not clear on is why doesn't the rate the I.D.B. charges vary more or less in relation to the cost of the money? In other words, why should the degree of subsidy or the degree

of unprofitability be changing from time to time in the recent period, when the cost of money has gone up more than the rates you charge? In other words, there is a larger element of subsidy, or whatever you wish to call it, now than there was a while ago. Why should this vary?

MR. RASMINSKY: Well, it is felt, Mr. Gibson, that the I.D.B. rate should not be varied too frequently. Even as it is, the I.D.B. rates have varied more frequently than some other institutional rates, which is shown in this list on C-1. You will notice that it has been changed more frequently than the chartered banks' prime rate. In the period covered by this table the I.D.B. rate has been changed eight times, whereas the chartered banks' prime rate has been changed five times. This is in the table on C-1.

The spread between the average rate of interest on new loans made and the average rate of interest on new debentures issued -- that is, the cost of money to the I.D.B. -- has not varied in fact within an extremely wide range. Perhaps I might read out those spreads -- I am sorry; those spreads are given at G-2.

COMMISSIONER GIBSON: I am really talking about the very sharp reduction in the second half of 1962.

MR. RASMINSKY: That is right. The sharp reduction in the second half of 1962 reflected the fact that the I.D.B. rate was not immediately adjusted to the increase in the average rate of interest on new debentures, and, consequently, in the second half of 1952 as compared with the first half of 1952 the spread between these two rates fell from 2.10 per cent to 1.59 per cent. It was then adjusted, and if you look at the position for the first quarter of the fiscal year 1963 -- I am afraid you cannot look at that position because it is not in the submission, but in the first quarter of 1963 ---

COMMISSIONER GIBSON: That is from October to January?

MR. RASMINSKY: Yes, October, November and December; it is to January 1. The average rate of interest on new loans made by the I.D.B. was then 7 per cent, up from 6.58 per cent. The average interest rate on new debentures issued was 5.22 per

cent, and the spread, consequently, was 1.78 per cent.

On January 15 the average rate on new loans made by the I.D.B. was still 7 per cent. The average interest rate on new debentures issued had fallen to 5.04 per cent, so the spread was back up to 1.96 per cent which is, apart from the position in the first half of the fiscal year 1962, as you will see, rather higher than it has been in recent years.

COMMISSIONER GIBSON: So you would describe this big change in the spread as simply a lag, and not a matter of policy?

MR. RASMINSKY: That is right, yes.

COMMISSIONER BROWN: In view of the fact that the debentures are issued to the parent company, the fact that you borrow in a maturity range different from your asset range is immaterial, I suppose?

MR. RASMINSKY: There is, in fact, a pretty close relationship between the maturity range of the debentures and the asset range.

COMMISSIONER BROWN: Except that you have some assets running up to 15 years, and no maturities beyond six years.

MR. RASMINSKY: That is right. There is not a complete coincidence.

COMMISSIONER BROWN: The average term of your debentures is obviously just over three years to keep them at maturities of from one to six years.

MR. RASMINSKY: Yes. A characteristic loan would be one that would be repaid within seven or eight years, although we do have some longer term

loans, so the average term of the loans outstanding would not be all that different from the average term of the debentures outstanding.

COMMISSIONER BROWN: Has consideration ever been given to making an outside issue at all?

MR. RASMINSKY: Yes, it has, Mr. Brown. From time to time we have thought of it and some interest has been shown in this on the part of investment dealers. I would not want to exclude the possibility of an outside issue of I.D.B. debentures. Up to the present it has not seemed appropriate to try an outside issue.

COMMISSIONER BROWN: Because there would be a presumption that they would cost more in the total picture, anyway?

MR. RASMINSKY: I am not sure. The loading factor at present used by the Bank of Canada when it buys debentures is 60 basis points, and I would not be by any means sure that if the timing and the conditions were appropriate that an I.D.B. debenture could not be sold at a yield less than 60 basis points above the relative yield on government of Canada securities.

COMMISSIONER BROWN: I say "using the total picture" because presumably the spread of 0.60 is all within the government system, is it not? While it is a cost to I.D.B. it is a profit somewhere else in the whole picture.

MR. RASMINSKY: I see what you mean. Well, yes, but I think you have to take into consideration

what the Bank of Canada does not buy as a result of buying the I.D.B. debentures.

COMMISSIONER BROWN: Yes, so the Bank of Canada would buy at 60 cents, or something?

MR. RASMINSKY: Yes.

COMMISSIONER BROWN: I have one further question. The loss experience has not been too bad. I think Table 5 shows the bad debts actually written off each year. 1959 was a year in which you had to dip into surplus. You wrote off more than you actually provided for in that year, but otherwise it has been well within the provision for bad and doubtful debts. The question I would like to ask: Has there been any pattern about this? Have they been spread over the whole spectrum of small and large loans, or has your experience been relatively worse with one category of loan?

MR. JAMES: It has been spread generally across the board, I would say, in no particular marked pattern at all. Does that answer your question, Mr. Brown?

COMMISSIONER BROWN: Yes. Would there be any pattern in any region of the country?

MR. JAMES: Not particularly, no. I do not think any one area has been any different from another. It has been a fairly average kind of thing.

COMMISSIONER HARROLD: Mr. Chairman, I would like to ask two questions with respect to Section F, the organization of staff. You have

virtually the same board of directors on the I.D.B. as you have on the Bank of Canada with the exception of the Deputy Minister of Trade and Commerce. We have had some discussion about the role of the directors of the Bank of Canada. I suppose the role of the directors of the Industrial Development Bank would be very similar -- or, are there some differences?

MR. RASMINSKY: No, there are differences, Mr. Harrold. One of the differences is reflected in the legislation itself. You may recall that under Section 8 (1) of the Bank of Canada Act the Governor of the Bank on behalf of the Board has the direction and control of the business of the bank. That authority is to act in connection with the conduct of the business of the bank in all matters that are not by the act itself reserved to be done by the Board or the Executive Committee. There is no similar provision in the Industrial Development Bank Act which gives the President of the bank the power to act on behalf of the Board. Section 5 (1) of the Industrial Development Bank Act reads as follows:

> " The Bank shall be under the management of a Board of Directors composed of the members of the Bank, which may exercise all of the powers of the Bank."

A second difference still in the field of the legislation is that there is in the Industrial

Development Bank Act no veto power in the president similar to the veto power which the Governor of the Bank of Canada has under the Bank of Canada Act.

A third difference is that on the Industrial Development Bank's Board the Deputy Minister of Finance has a vote where he has no vote on the Board of the Bank of Canada. He also has a vote on the Executive Committee of the Industrial Development Bank where he has no vote on the Executive Committee of the Bank of Canada.

Then there are differences in the composition that you have referred to, Mr. Harrold, that both the Board of the I.D.B. and the Executive Committee of the I.D.B. include ex officio the Deputy Minister of Trade and Commerce as a voting member. Finally, the Executive Committee of the I.D.B. includes two executive directors selected by the directorate of the I.D.B. -- that is, the executive directors of the Bank of Canada plus another, who are not full-time residents of Ottawa, and who are not officers of the bank or senior officials of government.

There are those constitutional differences. Apart from these constitutional differences it is the case that the directors of the Industrial Development Bank play an active role in connection with the conduct of the day-to-day business of the Industrial Development Bank. Under the procedures that have been set up, loans of a certain size, or above a certain limit, have to be referred to the Executive Committee of the Industrial Development

Bank on which the part-time directors or, as we call them, the executive directors sit. Loans above a further limit authorized by the Industrial Development Bank have to be referred to the directors themselves for decision.

In addition, I am reminded that each week at meetings of the Executive Committee, the members of the Executive Committee have before them, and will indeed have received some days before the meeting, summaries -- and quite extensive and detailed summaries -- of all loans falling below the limit which has to be referred to them for decision which have been approved in the course of the preceding week, and this provides the executive directors with the means of watching very closely the operations of the bank.

COMMISSIONER HARROLD: Are these limits changed from time to time? Would you give us some indication of the size of the limits?

MR. RASMINSKY: Yes, they are changed from time to time. At the present time, Mr. Harrold, any loan of $200,000 or more has to be referred to the Executive Committee for approval, and any loan of $500,000 or more has to be referred to the Board of Directors for approval.

These limits include not only the direct loans, but any loans that may have been made to related companies of the applicants.

COMMISSIONER HARROLD: I think Mr. Beattie referred to the fact that interest changes

are sometimes delayed until after the meeting of the Board of Directors. Does this indicate that these changes should not be made except following a meeting of the Board of Directors?

MR. RASMINSKY: Mr. Beattie referred to the fact that changes in interest rate might on occasion be approved by the Executive Committee rather than by the Board of Directors. Changes in the fixed rate of interest come under one of the powers of the Board of Directors of the bank. Like all other powers, except certain reserved powers that are reserved in the Act itself, this power can be exercised by the Executive Committee, and any change in the fixed rate of interest would require to be approved by the Executive Committee.

Normally, a change in the rate of interest would be approved by the whole Board. The changes take place infrequently enough that one can wait until the next board meeting.

COMMISSIONER HARROLD: In the role of the directors in assessing staff, and having regard to the fact that the head office is in Ottawa and the general manager's office and most of the senior staff at that level are in Montreal, is the same practice followed as in the Bank of Canada, that senior officers from the general manager's office attend meetings of the Board of Directors and of the Executive Committee?

MR. RASMINSKY: They invariably attend a meeting of the Board of Directors. On occasion,

but not invariably, they attend meetings of the Executive Committee. Of course, the officers of the bank who are in Ottawa are in constant touch with the general manager's office by telephone.

COMMISSIONER HARROLD: How much outside work does the Industrial Development Bank have done for it by experts, say, in the legal field? Is there legal work done by your own staff, or is that done outside?

MR. JAMES: We use our own legal staff for checking or vetting loans, but the work in connection with the security for a loan is usually done by the legal firms across Canada. Our own legal staff checks it to make sure that it is a good security.

COMMISSIONER HARROLD: Do you use the services of experts in other fields in connection with applications for loans?

MR. JAMES: No outside experts, Mr. Harrold, are used.

COMMISSIONER HARROLD: I have just one more question and that is in connection with the considerably enlarged staff you have now as compared with three or four years ago. Do you in the Bank of Canada use this network of outside experts in your line of work for supplying information for economic developments that might be of some use in the Bank of Canada in deciding on a monetary policy as such or on conditions in the country in general?

MR. RASMINSKY: I find, Mr. Harrold, the flow of information that reaches us in the Bank of Canada as the result of our connection with the Industrial Development Bank regarding the position of individual applicants who come in, what their experience has been not only in their own business but also in looking for credit from other sources, I find this flow of information useful to me in my capacity as Governor of the Bank of Canada.

COMMISSIONER HARROLD: Those are all the questions I wish to ask.

COMMISSIONER GIBSON: I have a couple of questions, Mr. Chairman, of a very general nature.

Mr. Rasminsky, would you have any comments to make about some of the newer lenders in the field in which the Industrial Development Bank is now operating? You referred earlier to lenders widening their activities, and there have been new entries into this field. There have been a couple of new businesses recently formed to finance new ideas, particularly in the smaller business area. Have you any comments you

would like to make about this?

MR. RASMINSKY: The only comment I would wish to make on this, Mr. Gibson, is that I welcome the establishment of the firms to which you are referring. I welcome the initiative that is shown by private enterprise, investment dealers and insurance companies, banks and others, who have been concerned in the establishment of these firms to move into this general field of lending in which the Industrial Development Bank has been participating. In the case of many of these firms the I.D.B. has established quite friendly relations. It would not be going too far to say that we have been of some help to some of them. I see no conflict whatever between the activities of the Industrial Development Bank and the activities of the firms which I believe you have in mind.

COMMISSIONER GIBSON: Nevertheless, some of them have been a little critical of your interest rates before us. Is there anything you think that could be done to clarify the relationship of the Industrial Development Bank to other people in this field?

MR. RASMINSKY: Anything that you can do, that the Commission can do?

COMMISSIONER GIBSON: No. Are you satisfied with the relationship between the I.D.B. and these other people who are moving into this area? I rather think there has been a sizeable movement in this direction in the last five or six years.

MR. RASMINSKY: I do not see anything specific that should be done at the present time other

than to keep each other generally informed as to the line of business that they are in, and to look perhaps for occasions for joint ventures, cooperative efforts. These are the only comments that occur to me to make on that question, Mr. Gibson.

COMMISSIONER GIBSON: As a sort of last question may I ask whether there are any comments you would like to make about the present and prospective state of the "small business problem" as it exists in Canada?

MR. RASMINSKY: You saved that until the end.

COMMISSIONER GIBSON: Well, it gives you an opportunity to say anything more you might wish to say before this Commission.

MR. RASMINSKY: I do not think I have anything important to say on that subject, Mr. Gibson. With the growth of the economy and efforts of the I.D.B. and the recent creation of a variety of new institutions, notwithstanding the very considerable contribution which has been made through these combined efforts of government, through the Industrial Development Bank and these private institutions to provide for the financial requirements of small business, I think there is still a lot to be done. I do not believe that we are in a position where we can relax and feel that the MacMillan gap, so-called, has been filled and that there is nothing more to be done about it. There is a good deal more to be done, and in doing what remains to be done it is my belief there is an important role both

for the Industrial Development Bank and for private financial institutions.

THE CHAIRMAN: There is just one question I should like to ask. It has been put to us by some of the representatives of the chartered banks that, if the 6 per cent ceiling were lifted, perhaps a considerable amount of the business now done by the Industrial Development Bank could be handled and probably would be done by the chartered banks. They were speaking not only of the 6 per cent ceiling but also with respect to permission to enter into mortgage securities. That, of course, would have to go along with it. Would you care to comment on that?

MR. RASMINSKY: I am sorry. I did not get what the question was, Mr. Chairman.

THE CHAIRMAN: It has been suggested that if the ceiling were lifted and if the banks were given the power to invest in mortgage securities, that they would then be interested in doing a considerable portion of the sort of business that the Industrial Development Bank is doing and would, to a considerable extent, invade that field, in other words. Would you care to comment on that? Would you visualize that such a trend might take place under those circumstances?

MR. RASMINSKY: I can imagine, Mr. Chairman, that under the conditions you have postulated in your question there may be some loans made by the Industrial Development Bank which would be regarded as attractive to one or other of the chartered banks. I would be inclined to doubt whether under those conditions, the

conditions which you mentioned, if the banks were relieved of the statutory ceiling of 6 per cent and were free to take mortgage security and generally to operate on the same basis as the I.D.B., I would be inclined to doubt that the I.D.B. would receive any offers from the banks to take over the whole of our portfolio.

As I have indicated, many of the loans made by the Industrial Development Bank are unprofitable loans because they involve costs that are high in relation to the magnitude of the loans. So that I think the answer would be, yes, the Industrial Development Bank might under those conditions not make certain loans that it would otherwise be making, but I think there would still be a great many loans, both in terms of number and in absolute amount, to small and medium size business that the I.D.B. would continue to make because the banks would not wish to make them.

THE CHAIRMAN: You would not expect that you would be driven out of the business entirely as a result of the activities of the chartered banks?

MR. RASMINSKY: No, sir.

COMMISSIONER LEMAN: Berhaps the banks would buy at par the loans outstanding from the Industrial Development Bank now that all the preliminary costs of investigation, and so on,has been paid off. You do not need to answer that question, Mr. Rasminsky.

COMMISSIONER BROWN: The banks might pay over par for them.

THE CHAIRMAN: Are there any other questions?

Well, gentlemen, that concludes the discussion on the brief of the Industrial Development Bank. It also terminates the public hearings of the Royal Commission on banking and finance. The hearings commenced on March 12, 1962, and were held at Victoria, Vancouver, Edmonton, Regina, Winnipeg, Toronto, Montreal, Fredericton, Charlottetown, Halifax and Ottawa.

During the course of these hearings the Commission heard 96 briefs from individuals, associations, organizations, and various provincial governments.

Once again I may say, Mr. Rasminsky, that we are very much indebted to you and your staff for the contributions you have made to these hearings. We are also indebted to the many others, institutions and individuals, who have appeared before us for the great variety of contributions which have been made.

The time has come for us to reach decisions on these various problems, some of which we have discovered are somewhat controversial in many respects.

We thank you very much and we hope that you will be with us in spirit during our deliberations.

MR. RASMINSKY: Indeed, I shall. Thank you very much, Mr. Chairman.

--- The hearings were concluded.

Royal Commission on Banking and Finance

THE INDUSTRIAL DEVELOPMENT BANK

Hearings held at

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SUBMISSION BY THE INDUSTRIAL DEVELOPMENT BANK TO THE ROYAL COMMISSION ON BANKING AND FINANCE

INDUSTRIAL DEVELOPMENT BANK

Head Office: Ottawa, Ontario

The Hon. Dana Porter,
Chairman,
Royal Commission on Banking and Finance,
Toronto, Ontario

Dear Sir,

I have the honour to provide herewith the submission of the Industrial Development Bank to the Royal Commission on Banking and Finance. All statistics relating to 1962 which are contained in this document are preliminary, and final figures will be sent to you as soon as they are available.

In addition to the submission itself I have included copies of certain related material which you may find of some value. These are:

(1) Annual Report for 1961

(2) Booklet "A Source of Financing for Canadian Business"

(3) Application for Credit

Yours very truly,

W. Radiminsky,

President.

INDUSTRIAL DEVELOPMENT BANK

SUBMISSION TO

ROYAL COMMISSION ON BANKING AND FINANCE

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A - Background

The Industrial Development Bank was established by Act of Parliament in 1944. Before that time there was no financial institution in Canada to provide a regular source of medium or long-term financing for small and medium-sized businesses which were unable to raise funds in the securities market. Short-term credit for business was available from the banking system but in general longer-term funds were available only from non-institutional sources. Banks were not permitted to make loans on the security of land, buildings or other fixed assets, and other institutional lenders such as insurance and trust and loan companies were, so far as smaller mortgages were concerned, mainly interested in lending on residential rather than business property. During the latter part of World War II there was special interest in broadening the sources of financing for industrial development due to the general concern that the transition from war-time to peace-time activities might give rise to serious unemployment.

A "gap" in institutional sources of business financing had also been recognized in the United States and the United Kingdom and facilities somewhat similar to the Industrial Development Bank had been or were being created to help deal with it. In the United States the Federal Reserve Banks could provide medium-term credits to business borrowers under the provisions of Section 13(b) of the Federal Reserve Act. In the

United Kingdom consideration was being given to two new Government-encouraged financial institutions as means of assisting with the problem of medium-term business financing. One of these institutions was the Industrial and Commercial Finance Corporation whose capital was to be jointly provided by the Bank of England and the commercial banks. The other was the Finance Corporation for Industry, whose capital was to be subscribed by insurance companies, investment trusts and the Bank of England; it was intended that this corporation would provide medium-term finance for rather larger companies than the Industrial and Commercial Finance Corporation would be expected to assist.

In Canada the new organization for medium-term business financing was set up as a public institution which would have all its stock subscribed by the central bank and which it was intended would supplement rather than compete with the activities of other lenders. It was to provide credit only when this was not available elsewhere on reasonable terms and conditions. The Industrial Development Bank Act also indicated that:-

(1) The IDB was to confine its lending to enterprises which seemed likely to be financially successful and able to repay their borrowings from the Bank.

(2) The IDB was to be particularly concerned with the financing problems of smaller business enterprises.

These guiding principles were set forth in the preamble to the Industrial Development Bank Act which reads as follows:

> "Whereas it is desirable to establish an industrial development bank to promote the economic welfare of Canada by increasing the effectiveness of monetary action through ensuring the availability of credit to industrial enterprises which may reasonably be expected to prove successful if a high level of national income and employment is maintained, by supplementing the activities of other lenders and by providing capital assistance to industry with particular consideration to the financing problems of small enterprises:"

The IDB's lending principles are also referred to in Section 15 of the Act (see page 8A).

In view of the fact that the IDB would be operating in a new field of lending and would have problems of acquiring or training staff with the necessary specialized skills, its operations were at first limited to the area in which the immediate need for its facilities was expected to be greatest. Under the Act of 1944, therefore, IDB lending was confined almost entirely to manufacturing enterprises, where the importance of investment in fixed assets made the provision of longer-term capital funds a particularly urgent problem. As the Bank acquired operating experience and as it became apparent that businesses other than manufacturing also had substantial problems of raising medium and long-term funds to finance capital expenditures, the scope of the IDB's operations was broadened. Commercial air services were made eligible by an amendment to the

Act in 1952 and the definition of eligible enterprises was broadened considerably by an amendment in 1956. In 1961 the IDB's field of lending was enlarged to the point where almost all types of business are now eligible including retail and wholesale trade, hotels, motels, and the provision of recreational facilities and professional services.

B - Lending Policy

Section 15 of the Industrial Development Bank Act empowers the Bank to extend credit to any industrial enterprise in Canada provided that such credit would not otherwise be available on reasonable terms and conditions and provided also that the character of the investment and the amount invested by others are such as to afford the Bank reasonable protection.

The Bank interprets this Section of the Act to mean that it should go as far as it can to meet applications for financial assistance which appear to satisfy the foregoing requirements. No approach to the Bank is declined on the grounds that the effort required to investigate it and reach a decision would be disproportionate to the financial return which might be earned on it by the Bank. The Bank is prepared to give just as much attention to small loans and to borderline proposals as to larger requests which would provide a greater financial return to the Bank. It is not unusual for an application to the IDB for (say) a $15,000 loan to receive considerably more effort and time than one for (say) $100,000.

Frequently, a small business is dependent upon one or two principals who may be highly skilled in certain respects such as production or sales but may be less experienced in accounting and finance. As a result, the applications which the Bank receives from small businesses sometimes have, in their original form, weaknesses which would justify declining the application.

However, the Bank's approach is to look into the matter carefully in order to ascertain whether it is possible to work out some basis - perhaps different from that originally proposed - on which the Bank can assist the applicant.

A prime factor in determining the extent to which the Bank can help provide financing is the future earnings prospects of the business. To assess this feature properly it is necessary to consider carefully all aspects of an applicant's business. In most cases which appear to warrant serious consideration by the Bank this includes a visit to the applicant's place of business for on-the-spot discussions with those responsible for the operation of the enterprise. This adds to the effort and time required to process applications but in the experience of the Bank it greatly improves the Bank's understanding of the business and its problems and enables the Bank to maximize its financial assistance. The Bank continues to try to shorten the time taken to process applications and has, on average, reduced this period appreciably in recent years.

The Bank makes a practice of following the progress and problems of borrowers after loans are approved and the proceeds disbursed. The principal way in which this is done is to have borrowers furnish financial statements periodically. By keeping in touch with events the Bank is frequently able to help the borrower, if difficulties develop, before they have progressed too far.

When changing circumstances and the financial condition of the business warrant, the Bank may amend the original terms and conditions of loans. For example, it may be that before a loan is repaid the borrower is faced with the need to acquire additional fixed assets. The Bank may be able to assist by deferring a number of principal instalments on its loan and adding them on to the end of the originally scheduled repayment period. This is also sometimes done to ease a tight working capital position or to see a business through a difficult period when earnings have been temporarily reduced. During the past year the Bank agreed to defer payments for a period of several months in the case of approximately 250 customers.

In numerous cases the Bank also provides further assistance by making an additional loan before the outstanding loan has run its course; such loans accounted for 16% by number and 17% by amount of the Bank's total loan authorizations during fiscal 1962.

Funds Not Available Elsewhere on Reasonable Terms and Conditions

The general approach which the Bank takes to satisfy itself that the credit being applied for would not be available elsewhere on reasonable terms and conditions is as follows:-

1. On the signed application which the IDB obtains from each applicant, the applicant certifies that he "is unable to obtain the loan from other sources on reasonable terms and conditions".

In any case where it seems to the Bank that the overall needs of the applicant might be met from some other source, the Bank suggests that the applicant discuss his needs with any source of credit which he may have overlooked.

2. On the application form, the applicant agrees to instruct his chartered bank to give the IDB full information concerning his affairs and the IDB writes the chartered bank, explaining that an application has been received and requesting a banker's report on the applicant. This serves two purposes: it provides the IDB with an up-to-date report from the bank at which the applicant is well known, and it also advises the chartered bank of its customer's intention to seek financing from the IDB. The chartered bank thus has an opportunity to intervene if the situation appears to be one in which it could itself appropriately provide medium or longer term financing.

3. If an application for credit is of a size and character which makes it seem possible that a mortgage lending institution would be interested in providing the required funds, the applicant is asked to contact this type of lender.

4. If the applicant business is a subsidiary of a large company or is controlled by a wealthy individual, the IDB considers that there is a presumption that funds are available from the owner and, unless it can be specifically shown

otherwise, the applicant is expected to obtain the needed funds from that source.

5. If it appears that the applicant could obtain funds by way of a public issue of stock or securities he would be expected to explore this possibility by contact with those engaged in the underwriting business. However since a business must be well known and have a proven management and a well-established earnings record before it is able to make a public issue of stock or securities and since the underwriting costs bear heavily on small issues the Bank does not encounter such a situation very frequently.

6. If an application to the Bank involves refinancing lien obligations which are held by another lender in more than a relatively small amount, the applicant is asked to get in touch with the other lender to try to re-negotiate the terms of his contract on a mutually satisfactory basis.

7. Applicants who appear to come within the scope of the Small Businesses Loans Act are advised of the existence of the facilities provided under this Act through the branches of chartered banks.

8. Applicants who appear to come within the scope of such legislation as the Farm Credit Act are directed to the appropriate government department or agency.

There is no problem for the IDB if an applicant finds that the funds which he needs are available elsewhere on any terms. If, however, the applicant reports that the funds are available but only on terms which he does not regard as reasonable, the IDB is placed in the position of having to form an opinion on this point.

One of the important considerations in deciding whether the terms offered are reasonable or not is the amount of the periodic payment of principal and interest required in relation to the business's anticipated net earnings and ability to repay. In this connection variations in the duration of the loan have a much greater effect on the required size of periodic payments than differences in the rate of interest. Sometimes the Bank finds that funds are available elsewhere only for a term of two to three years when the anticipated earnings of the borrower indicate that a five or six-year term is required and that such a term would be sound from a credit point of view.

The task of deciding whether alternative terms and conditions of financing are reasonable is unusually difficult when a borrower requires funds for a variety of purposes. Financing may be available elsewhere for some of these purposes on terms which would be considered reasonable if these constituted the entire programme. But if the effect of accepting a loan from this source for the particular purpose for which the money was available were to make it much more difficult or even impossible for the IDB or another lender to

finance the remainder of the programme, the overall result would clearly not be reasonable. In such circumstances the IDB may provide all the financing required even though some part of it, taken by itself, could be financed elsewhere on "reasonable" terms.

If the duration and other conditions of a loan offered by another lender appear reasonable, the rate of interest to be charged as compared with the IDB's own lending rate may become a consideration in deciding whether the IDB should make credit available. The Bank does not take the position that any rate of interest in excess of its own prevailing lending rate is for that reason to be regarded as unreasonable.

Eligible Borrowers

The amendment of the IDB Act in July 1961 broadened the field of the Bank's lending very substantially, to the point where it is now empowered to lend to:

> "an enterprise in which is carried on any industry, trade or other business undertaking of any kind".

Of the businesses currently obtaining loans from the IDB only 39% by number would have been eligible under the terms of the original IDB Act of 1944.

Apart from legal considerations as to what constitutes an eligible enterprise, it has been deemed inappropriate on grounds of public policy for the Bank to lend to certain types of business. For example, from the outset policy considerations have

ruled out loans to distilleries. Even when Parliament in 1961 made the definition of an eligible enterprise as broad as it now is, it was made clear in Parliament that the new definition was not intended to include such businesses as race courses or those which obtain a substantial portion of their revenue from the sale of alcoholic beverages.

Purposes for which the IDB lends

It is not possible to give a precise accounting of the purposes for which borrowers have used IDB funds because the IDB loan is normally less than the total programme being financed and additional funds are usually injected from other sources to round out the programme. For example, while the total of IDB loans authorized in fiscal 1962 was $90 million, the total programmes of the borrowers were $121 million with more than half of the difference being put up by the owners of the businesses. The main categories of uses and sources of funds in connection with customers' programmes in which the IDB participated by making new loans in fiscal 1962 were as follows:-

Customers' Programmes - Fiscal 1962

Programme	Millions of Dollars	Percent of Total
Land and Buildings	55.1	45.7%
Equipment	33.9	28.1
Working Capital*	14.3	11.9
Refinancing Mortgages (mainly realty)	5.1	4.2
Refinancing Suppliers' Liens	1.9	1.6
Refinancing Other Liens	3.9	3.2
Refinancing Other Obligations	3.2	2.7
Change of Ownership	1.2	1.0
All Other	1.9	1.6
Total	120.5	100.0%
Financing		
IDB	90.0	74.7%
Working Capital	6.6	5.5
Shareholders' Funds	16.1	13.3
Other Sources	7.8	6.5
	120.5	100.0%

* Including replacement of working capital depleted by capital expenditures.

The purposes for which the IDB lends may be described in more detail as:-

(a) To finance the purchase of fixed assets.

The chief purpose for which small and medium size businesses have come to the IDB has been to finance new investment in fixed assets and this accounts for almost three-quarters of the total of business programmes in which the IDB participated in fiscal 1962. IDB loans have enabled numerous businesses to construct new buildings, to purchase or alter or enlarge existing premises, and to purchase machinery and equipment, including aircraft.

Not uncommonly, the IDB is approached by a business which had proceeded with an expansion programme in the belief that it could be financed, in part at least, out of the working capital of the business, only to find on completion of the programme that its working capital was strained too far in the process. The IDB has made many loans to restore working capital which had been depleted to pay for capital expenditures.

(b) To increase working capital.

It has not been the policy of the Bank to provide funds to finance inventories or receivables as an alternative to borrowing from chartered banks or from other sources of such current financing. Normally, a business which comes to the IDB has an established line of credit with a chartered bank, and the granting of an IDB loan does not disturb that connection. The chartered bank continues to provide the necessary operating credit, primarily on the security of

receivables and inventories, while the IDB's term loan is secured by fixed assets and carries a higher rate of interest.

However, the programmes financed by the Bank involving physical expansion often create a need for additional working capital which can be met only partly by an increased operating credit from the borrower's chartered bank. For this reason, programmes financed by the Bank sometimes include an element of additional working capital.

(c) To finance a change of ownership.

In earlier years it was not considered a function of the Bank to help finance changes of ownership. Where, however, the change in ownership can be regarded as a constructive one for the business, i.e. where it would result in a significant improvement in the efficiency of the management, the Bank has in recent years been prepared to participate in the financing.

In particular the Bank is prepared to assist Canadians to buy a Canadian business which might otherwise be sold to non-residents or to help Canadians buy a business which is owned by non-residents. The Bank may also be able to assist the owner of a business who faces or anticipates financing difficulties in connection with estate taxes, which might otherwise lead him to dispose of the business or of a controlling interest in it.

(d) To repay term obligations.

Sound lending practice usually requires

that the IDB obtain as security for its advances a first charge on all fixed assets of the borrowing business. Typically, the business needs to borrow to the limit to finance its intended programme. The IDB can usually go further towards providing the required financing if it is able to obtain a first charge on all the fixed assets of a complete operating unit than it could go if it were able to obtain security on only part of those assets. Indeed any one lender having as security a charge on all of the fixed assets comprising a going concern and being the only term creditor looking to the future earnings of the business for repayment, is in a position to do more for the business than would be possible if two or more lenders were to share the security and to have concurrent and possibly conflicting claims on the earnings of the business. In some cases, therefore, in order to achieve the sound maximum of total term financing for the business, the IDB may advance funds which are used to pay off other creditors.

There are also some cases in which existing financial obligations may create a difficult problem for the borrower if they involve heavy repayments of principal over a relatively short period of time and place an excessive claim on the flow of funds from the business. If the business is creditworthy and has adequate prospective earning power over a longer period and the borrower is not able to secure a modification of terms from the existing lender, the IDB may be able to help by providing longer-term funds to

permit repayment of the existing indebtedness.

Investment by others

Section 15 (1)(c) of the IDB Act makes it a prerequisite that "the amount invested or to be invested in the industrial enterprise by persons other than the Bank, and the character of that investment, are such as to accord the Bank reasonable protection". The Bank takes into consideration not only investment in the form of equity but also loans from shareholders or others, provided there is assurance that such loans will be left in the business while the IDB is participating in its financing.

Credit Judgment

If a credit application conforms to the requirements mentioned earlier in this section - that is, if funds are not available elsewhere on reasonable terms and conditions, if the applicant is engaged in a type of business to which the IDB may lend, if the funds are required for an appropriate purpose and if there is a reasonable investment in the business by others - then it becomes a matter of credit judgment.

In this respect, the Bank's decision as to whether and how much it can appropriately lend to an applicant rests chiefly on the earnings prospects of the enterprise. The security offered and the degree of protection it may afford is, of course, a consideration, but the IDB places the greater weight on the earnings potential of the business. This emphasis on repayment from earnings accounts for the approach the

IDB has adopted to its lending operations, which involves taking a broad look at the applicant business and its future prospects. It would be much simpler to limit consideration of an application to the value of the security which is offered - and to limit the Bank's assistance to some specified percentage of that amount - but by emphasizing and enquiring into the earnings potential of the business, the IDB is often able to go further in providing financing.

Security

While the form of security varies from loan to loan and from province to province, the principal security is usually a realty mortgage, chattel mortgage or mortgage bond. In the case of an incorporated business, the personal guarantee of the owner, or owners, for a portion of the loan may be required. A corporate borrower which is a subsidiary of another corporation or is closely related to another company may be required to provide the guarantee of the parent or affiliated company. It is a normal condition of all loans that the borrower maintain and assign to the Bank adequate insurance on the mortgaged assets. Insurance on the life of the principals of the business is sometimes required. IDB loans are commonly subject to underlying conditions designed mainly to keep the Bank advised of developments within the business while its loan is outstanding and to provide protection against developments which might jeopardize the financial condition of the business. These conditions usually

include the periodic submission of financial statements and agreement on such matters as the level of capital expenditures which may be made in the future without prior consultation with the Bank.

Period of Repayment

IDB loans are normally repaid by means of monthly or quarterly instalments. The loans authorized in fiscal 1962 had an average repayment period of nearly seven years and the maximum term was fifteen years. As shown in Table 13 there has been a tendency in recent years towards somewhat longer repayment periods. In addition, as mentioned on page 10A, the Bank often grants extensions of the original period of repayment of loans.

There is also a period between the date of authorization of the loan and the date of commencement of repayments which in fiscal 1962 averaged 4.9 months. The IDB's practice is to set the date for commencement of repayments in such a way that the borrower will have had some opportunity to benefit from the programme being financed with the IDB's help.

In determining the appropriate period of repayment for a loan, consideration must be given to the expected earnings of the business and the extent to which earnings will be required for other purposes, such as to strengthen working capital and to make essential continuing capital expenditures including the replacement of worn-out or obsolete equipment. When the prime security consists of assets having a

particularly short economic life this factor must also be taken into account. To a greater extent than may be realized, the periods over which IDB loans are repaid reflect borrowers' own assessments of their ability to repay; most borrowers, like the Bank, take the attitude that the sooner borrowings can be repaid the better. In some cases, indeed the duration of the loan as made is greater than that originally requested by the borrower.

Circumstances seldom arise where repayment over more than fifteen years is either appropriate from the Bank's point of view or is desired by the borrower but there is no specified maximum period for repayment of IDB loans.

C - Rate of Interest and Other Charges

The establishment of the Bank as a separate institution with its own Income Statement, and the discussion which took place in Parliament at the time the Act was passed, make it clear that the Bank is expected to charge a lending rate sufficient to cover its cost of borrowing and other expenses (including losses) and provide some moderate return on its capital. The Bank's borrowing and other costs are discussed in detail in Sections G and H.

The relationship between the IDB's lending rate and certain other institutional lending rates, in the months in which a new IDB rate had been established, is indicated in the following table:-

	IDB Rate	Chartered Bank Prime Rate	NHA Maximum Rate	Farm Loan Board Rate	Rate on Conventional Mortgages
Nov. 1944	5	4½	4½	5	5
Feb. 1951	5½	4½	4½	4½	5 3/4
Apr. 1952	6	4½	4½	5	6
Sept. 1956	6½	5¼	5½	5	6¼
Nov. 1957	6	5 3/4	6	5	6 3/4
Mar. 1959	6½	5½	6	5	7
Oct. 1959	7	5 3/4	6	5	7
Sept. 1960	6½	5 3/4	6 3/4	5	7½
Sept. 1962	7	6	6 3/4	5	7¼

Occasionally the IDB makes a loan at a rate of interest higher than its general rate.

Sometimes such a loan is secured by a second charge on fixed assets where the prior encumbrance in favour of another lender is at a higher rate than the IDB's normal rate; since it is unusual to have a second mortgage bearing a lower rate of interest than the first, the IDB has often applied a higher-than-normal rate in such cases. In addition some loans involving relatively large amounts and above-normal risk have carried a higher rate.

As in the case of other term lenders the IDB charges - where they are relevant - certain fees which are described below.

Commitment Fee. The Bank makes no charge for the often considerable amount of work and expense involved in investigating a proposal. However, if the prospective borrower accepts the Bank's offer of credit and then fails to provide the relative security or to take up the loan within a stipulated period (normally four to five months), the Bank charges a commitment fee amounting to $50 for loans up to $25,000 and, for larger loans, $50 plus 2% of the amount by which the loan exceeds $25,000.

Standby Fee. If a loan is for more than $25,000 and if the borrower does not draw it within a specified period (usually four to five months) but wishes to retain the right to do so at a later date, the Bank charges a standby fee at the rate of 2% per annum on the undisbursed balance until it is reduced to $25,000.

Prepayment Indemnity. As in the case

of most of mortgages and other forms of term borrowing, an IDB loan may be prepaid, in whole or in part, at any time provided the borrower pays a prepayment indemnity. This indemnity ranges from 2% to 6% of the amount prepaid; the higher rate applies to prepayments made within the first three years and the rate declines 1% per annum thereafter to a minimum of 2%.

D - Number, Amount, Classification and Distribution of IDB Loans.

The number and amount of new loans made each year to new borrowers and to existing borrowers is shown in Table 8. After the first three years of initial growth, the volume of lending in terms of number of loans was relatively steady until after 1955. The increase which began in 1956 accelerated sharply in 1961 and continued in 1962.

The proportion of total loans made to new borrowers (as distinct from additional loans to existing borrowers before their previous IDB loans are fully repaid) has been rising. It was 66% in fiscal 1955 and was 83% in fiscal 1962. The increase has been accentuated by loans to businesses which were not eligible prior to the amendment of the IDB Act in July, 1961.

In total, from the commencement of operations in 1944 to the end of fiscal 1962, the Bank has approved over 8,100 loans to more than 6,200 customers for a total amount of $460 millions. Of these loans, more than 25% by number and nearly 20% by amount were made in fiscal 1962.

The number and amount of loans actually disbursed by the Bank is less than the number and amount approved (see Table 9). Some loans are cancelled after the Bank has approved the application but before the loan reaches the disbursement stage. The borrower may decide against proceedings with his

programme. Or it may be, for example, that the loan was intended to help finance additional facilities for a contract the borrower expected to obtain; if the contract is not obtained the IDB loan, being contingent on the contract, would be cancelled before disbursement. Occasionally another lender who was originally reluctant to provide the needed funds has been encouraged to do so by the fact that the IDB, after investigation, agreed to provide the financing; in this case, too, the IDB loan would be cancelled.

In some cases, before the loan is fully disbursed the borrower may decide to curtail the programme or may find that the programme can be completed at a lower figure than had been expected. In either case, the borrower does not require the full amount approved by the Bank and the unneeded portion is cancelled at the borrower's request.

The total amount disbursed during a fiscal year differs from the total amount of net authorizations in that year because of the time required, between authorization and disbursement, for preparation of security and for the borrower to proceed with his programme. During a period when the number of loans is increasing, the amount disbursed naturally tends to be less than the amount authorized. For example, in fiscal 1961 the net amount of loans and investments approved, after cancellations and reductions, was $61,986,000 and the amount disbursed was $47,504,000.

Classification of Loan Approvals by Type of Business (Table 10)

The broadening of the eligibility provisions of the IDB Act in 1952, 1956 and 1961 has had a pronounced effect on the distribution of IDB loans among the various types of businesses. The number and amount of loans to 35 categories of businesses (the first 17 being manufacturers) are shown for each fiscal year in Table 10.

Prior to 1956 virtually all loans made by the Bank were to manufacturing businesses. Commercial air services accounted for a small number of loans after that industry was made eligible by the amendment of 1952 and the amounts involved in such loans were relatively large in 1953 (9% of the total amount approved in that year), 1955 (13%), 1956 (29%) and 1957 (12%).

The 1956 amendment made many non-manufacturing types of businesses eligible and loans to such businesses have accounted for a steadily increasing proportion of total loans since then. The 1961 amendment, which made virtually all types of businesses eligible, had an even more pronounced and immediate effect in this regard, as shown in the table below:-

Fiscal Year	Loans to Manufacturers		Loans to Non-Manufacturers	
	Number	% of total	Number	% of total
1955	202	91%	19	9%
1956	308	88	41	12
1957	319	80	82	20
1958	431	75	140	25
1959	442	74	157	26
1960	501	68	239	32
1961	871	64	494	36
1962	800	39	1,240	61

Size of Loans (Table 11)

The preamble to the IDB Act refers to the need to give "particular consideration to the financing problems of small enterprises". In recent years the smaller loans - those of $25,000 and less - have been accounting for a growing proportion of the total number of loans made by the IDB, as shown in the table below:-

Fiscal Year	Number of loan approvals not exceeding $25,000
1955	38%
1956	38
1957	39
1958	43
1959	46
1960	46
1961	45
1962	50

Currently 50% or more of the loans which the Bank makes are for amounts not over $25,000 and less than 10% are for amounts over $100,000. The increasing proportion of smaller loans is no doubt due, in part at least, to the growing proportion of loans being made to non-manufacturing types of businesses whose financial needs tend to be less than those of manufacturing concerns.

While loans not exceeding $25,000 represent half of the total number being made by the Bank and thus account for a large proportion of the work of the Bank, they account for only 17% of the total dollar amount of loans being made and provide only a small proportion of the Bank's revenues.

At the top of its lending range, the Bank has made 24 loans of $1 million or more. Five of these were made to commercial air services in one year - fiscal 1956 - at a time when Canadian regional airlines were faced with the need to expand their facilities, largely to service the DEW-Line which was being built across northern Canada.

In line with the trend towards a higher proportion of loans of smaller amounts, the average size of loan made by IDB has been declining. The relative figures appear in Table 8. The average size of loan approved during the years 1954-57 exceeded $70,000, dropping to $63,000 in 1958 and then to the $52,000 level in 1959-61. There has been a renewed downward trend since then to $42,000 in the last half of fiscal 1962.

Distribution of Loan Approvals by Province (Table 12)

Table 12 records, for each province and the territories, the number and amount of loans made in each fiscal year. As shown in the table below, there is a fairly close correlation between the regional distribution of loans made by the IDB and the regional distribution of economic activity as measured by total employment and by capital investment expenditures.

	Regional Distribution of:			
	IDB Loan Approvals Fiscal 1962		Total Employment	Capital Investment Forecast
Region	Number	Amount	Fiscal 1962	Calendar 1962
Atlantic	7%	8%	9%	8%
Quebec	24	26	27	24
Ontario	37	37	37	36
Prairies	20	19	18	21
B.C., Yukon and N.W.T.	11	10	9	11
	100%	100%	100%	100%

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]			[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	

E - Equity Financing, Underwriting and Guarantees

Subject to the requirements discussed in Section B regarding eligibility, availability of funds from other sources on reasonable terms, and credit-worthiness, Section 15(1) of the IDB Act permits the Bank to:-

> "enter into underwriting agreements in respect of the whole or any part of any issue of stock, bonds or debentures of the corporation, and purchase or otherwise acquire with a view to the resale thereof, the whole or any part of any issue of stock, bonds or debentures of the corporation from the corporation or a share-holder thereof or from any person with whom the Bank has entered into an underwriting agreement in respect of the said issue."

Equity Financing

The Bank has been able and willing to participate in equity financing, but there has been very little opportunity to do so. In all but a hand-ful of cases, the Bank has found a term mortgage loan without equity participation to be the most appropriate method of providing the financial needs of the ap-plicant business, and a method more acceptable to the owners than one involving investment in its equity. Even in cases where the Bank has acquired an equity interest, the greater part of the total financing pro-vided by the Bank has been in the form of a secured term loan.

The explanation is to be found largely in the marked unwillingness of shareholders in a small business to dilute their equity. In the typical case encountered by the Bank, the business is owned and operated by the one or two individuals who founded it and who are accustomed to freedom of action which they feel would be curtailed if additional shareholders were to participate. They are optimistic about the prospects of their business and do not wish to share the fruits of success with others; while they may need financing, they do not want to give up equity in order to obtain it.

It is of course the case that if the IDB limited the amount of its term loans secured by the fixed assets of borrowing businesses to what other mortgage lenders would normally lend on such assets, the IDB would be lending significantly less than it is and there might be correspondingly greater need for supplementary financing in the form of equity participation.

The capital structure of the businesses financed by the IDB naturally has a bearing on what the IDB can do by way of equity financing. Half of the businesses which the IDB assists borrow an amount not exceeding $25,000 and about 75% borrow not more than $50,000. Businesses whose financial requirements are of this magnitude often have a rather narrow equity base; not only is the shareholders' investment small in dollar amount but it is not unusual for a substantial portion of that investment to take the form of loans to the

company; in some cases the shareholders' investment in shares may be no more than a nominal amount. Unless there is a broad capital base, it is impossible to make a worthwhile contribution to the financial needs of the business by way of equity investment without upsetting control. It would be both inappropriate as far as the Bank is concerned and unacceptable to the shareholders for the IDB to acquire share control of a business and the Bank's policy is to limit its participation in the equity of any company to a proportion well short of 50%. For a company which requires, say, $25,000 and has the earning power to repay a loan for that amount over seven or eight years, there is little need or scope for outside equity financing if, as may well be the case, the value of the outstanding common shares is no more than $10,000.

In practice, the cases where it has been appropriate and feasible for the Bank to obtain a minority equity interest have been very few in number. In eighteen years the Bank has acquired a stock interest in only 23 companies; common shares were involved in the case of 16 companies, preferred in 4 and a combination of common and preferred in 3. The Bank presently has an equity interest in 8 companies.

Underwriting

The Bank has the legal power to participate in underwriting agreements, but only one case suitable for utilizing this power has been found so far. The subject has been reviewed with investment dealers quite

recently and it may be that more opportunities can be developed along this line in the future than have occurred in the past.

Guarantees

Under Section 15(1) of the Act, the IDB may "guarantee loans of money", but in practice, the Bank has had few occasions to utilize this power. Such occasions usually involve an existing customer of the Bank whose affairs have taken an unfavourable turn, to the extent that the risk becomes unacceptable to the chartered bank which provides current financing for the business. As part of its endeavour to help keep the business going until the difficulties can be overcome, the IDB might agree to guarantee its customer's chartered bank advances in part, if that is the only basis on which the chartered bank is prepared to continue with the account. In all, 41 guarantees have been authorized. The Bank makes a charge for auarantees at the rate of 2% per annum on the daily balance outstanding under its guarantee.

A possible alternative to guaranteeing the chartered bank operating credit would be for the IDB to provide the required current financing directly by means of an operating loan secured by goods, wares and merchandise. Section 19 of the Act permits the IDB to take security on goods, wares and merchandise "in the same form and mode by which security on goods, wares and merchandise may be given under Section 88 of the Bank Act to a bank incorporated by the Bank Act", and

Section 18 permits the Bank to take, as security, warehouse receipts or bills of lading covering goods, wares and merchandise, the provisions of Section 18 being almost identical to Sections 86 and 87 of the Bank Act. In earlier years the IDB did establish operating credits for ten of its customers under circumstances described above. The experience with these accounts demonstrated that, for this type of financing to be handled efficiently, it is necessary for the lender to be in frequent - preferably daily - contact with the borrower and to be familiar with the day-to-day transactions involved in the current financing of his business. The chartered banks, having very many more branches than the IDB and being geared to this type of financing, are in a much better position than the IDB to provide operating credits on the security of current assets.

F - Organization, Staff and Public Information

The Industrial Development Bank reports to Parliament through the Minister of Finance. Its Board of Directors consists of:

The Governor of the Bank of Canada
The Deputy Governor of the Bank of Canada
The Deputy Minister of Finance
The Deputy Minister of Trade and Commerce
The 12 Directors of the Bank of Canada who are appointed for three-year terms by the Minister of Finance with the approval of the Governor in Council

The Governor of the Bank of Canada is President of the IDB and Chairman of its Board, which normally meets eight times a year. The Executive Committee of the IDB consists of the directors who are members of the Executive Committee of the Bank of Canada (that is, the Governor, Deputy Governor, Deputy Minister of Finance and one Director), together with the Deputy Minister of Trade and Commerce and one other Director selected by the Board. The Executive Committee meets every week and submits minutes of its proceedings to the next Board meeting.

The Head Office, in Ottawa, is concerned with the broader aspects of IDB policy. The General Manager's Office, which is located in Montreal, supervises the operations and staff of the Bank.

The Bank has 22 branch offices across

Canada. Offices were established in Montreal, Toronto, Winnipeg and Vancouver in 1944-6 and in Halifax and Calgary in 1956. Beginning in 1959, 16 more branch offices have been opened from St. John's, Newfoundland to Victoria, B.C. The branches are organized along regional lines; branch managers report to regional supervisors who in turn report to the General Manager.

The delegation of lending authority is such that currently about 72% of the total number of loans made by the Bank are approved at the branch to which the customer takes his proposal. About 14% are approved by a Supervisor in another city. For the remaining 14%, consisting of larger loans, the decision rests with senior officers at the General Manager's Office or, in the case of the largest loans, with the Executive Committee or the Board of Directors in Ottawa. Within the overall policies established for the Bank as a whole this decentralized arrangement permits the decision to be made in most cases in the field by staff well acquainted with local conditions.

The number and location of the Bank's branches has been largely determined by the volume of lending business already established and in prospect and by the desire on the part of the Bank to provide as prompt and convenient service to its customers as is possible consistent with economical operations. The Bank endeavours to accommodate businessmen in centres where it does not have a branch office by arranging periodic visits by representatives from the nearest branch. These visits are advertised in advance in the

local press to indicate when and where the representatives may be reached and to invite interested businessmen to enquire about the Bank's services.

The IDB requires the services of a specialized and well-trained staff which, at September 30, 1962, was divided among six main categories as follows:-

	Number	Percentage
Management	34	7%
Credit officers	126	27
Investigating officers	56	12
Legal officers	26	6
Insurance officers	11	2
Clerical	219	46
	472	100%
Men	268	57%
Women	204	43%

Staff located at branch offices account for 86% of total IDB personnel. The other 14% are at the General Manager's office in Montreal; these include the senior management of the Bank, centralized departments such as accounting, and the related stenographic and clerical staff.

The size of the staff has increased substantially over the past six years, as a result of the rapid growth in the Bank's activities in that period. The number of applications processed annually rose from

358 in fiscal 1955 to 2,900 in fiscal 1962, the number of customers on the books increased from 692 at the end of fiscal 1955 to 4,100 at the end of fiscal 1962, and the number of branches rose from 4 in 1955 to 22 at the present time. The increase in staff over this period is shown in the table below:-

	Total Number of IDB Staff
September 30, 1955	99
1956	119
1957	135
1958	162
1959	193
1960	251
1961	402
1962	472

Much the largest annual increase in staff occurred during fiscal 1961, most of it in the second half of the year. There had already been a strong upward trend in the Bank's lending activity in the early part of that fiscal year, and when the IDB Act was amended in July 1961 to make the Bank's services available to many types of businesses not previously eligible it became necessary to expand the staff substantially and quickly.

Additional staff was also needed to implement the policy of opening new branches, which was noted in the Budget Speech of June 20, 1961 as follows: "The number of branch offices has been increased from four to thirteen over the past five years, and further

branches will be opened in the near future as suitable staff can be recruited and trained. This expansion has been very desirable and has had the full support of the Government." While the opening of a new branch reduces the territory served by adjoining branches, it invariably increases the total volume of business and adds to the over-all need for staff.

In the first years of its operations the Bank relied heavily on investigating officers and credit officers who had already had considerable experience and training before joining the Bank. In the case of investigating officers most had a background in engineering work. Credit officers were drawn from accounting, banking and various other types of business. As the Bank has grown and particularly since the large increase of staff in 1961, it has been necessary to recruit staff with less previous practical experience and train them in the service of the Bank.

Public Information Programme

As the organization charged with carrying out Parliament's intention to ensure the availability of credit to sound Canadian businesses of small or medium size which have been unable to obtain financial assistance from other sources on reasonable terms and conditions, the IDB clearly has some obligation to make its services known to those who might be in need of them. One might expect that awareness of the existence of an organization such as the IDB, and at least a general understanding of its function, would spread

rapidly through the business community. The IDB has found, however, that it could not be assumed that this would occur without positive action by the Bank. Even after the IDB had been in operation for a dozen years, it was apparent that the Bank was not adequately known among those who might obtain financial assistance from it, or their advisers. A complicating factor has been that many businesses approached the IDB in its early years only to learn that they were not -- at that time -- eligible. It has therefore been necessary to make such businesses aware of the enlargement in the Bank's terms of reference, especially following the 1961 amendment.

The Bank has tried to make its services better known in a number of ways. Advertising by the IDB has appeared in newspapers and appropriate magazines in Canada for a number of years, but greater emphasis has been placed on such advertising during the past two or three years. In accordance with the increased emphasis placed by the Bank on its public information activities, an information officer was appointed to its staff in November 1960.

The Bank's staff accept invitations to address business groups, trade conventions, service clubs, and other interested audiences about the function and operations of the IDB. The Bank also had a 20-minute colour film prepared in 1960. The film records an actual case history of the development of a new business and the part the IDB played in its financing, and goes on to explain the Bank's operations in a general

way. The English and French versions of the film have been widely shown across Canada by IDB officers -- more than 260 times to a combined audience estimated at more than 13,000 persons, and there have been a number of showings on TV undertaken by stations as a public service without charge to the Bank.

G - Sources of Financing

The Bank obtains its financial resources in three main forms, viz: share capital, the Reserve Fund built up through retention of profits, and debentures issues.

Share Capital

Section 12 of the IDB Act stipulates that the Bank of Canada shall subscribe for the authorized share capital of the IDB. The original $25 million of capital was issued between 1944 and 1947. When the IDB Act was amended in 1961, the amount of authorized capital was increased to $50 million and the Bank of Canada is taking up the additional $25 million pari pasu with the increase in debenture financing which was authorized at the same time, i.e. for each $10 million increase in debentures outstanding, the Bank of Canada purchases another $1 million of IDB capital stock.

Reserve Fund

According to Section 26 of the IDB Act, the full amount of profit remaining each fiscal year after provision for bad and doubtful debts, depreciation, etc., must be transferred to the Reserve Fund, which amounted at September 30, 1962 to $16.2 million. No dividends may be paid while the Reserve Fund of the Bank is less than its paid-up capital. The maximum dividend which may be paid thereafter is 4% per annum.

Debentures

Under Section 13 of its Act the IDB may "issue and sell bonds and debentures bearing such rates of interest and subject to such terms and conditions as the Board may approve", provided the aggregate of such indebtedness (plus the amount of contingent liabilities) does not exceed five times the sum of paid-up capital and Reserve Fund. At September 30, 1962 paid-up capital was $30 million, the Reserve Fund was $16.2 million and debentures could be issued up to an amount of $231 million. By the time the full $50 million of authorized capital is issued, the Bank's loans and investments would be somewhat more than $400 million as compared with $172 million at September 30, 1962.

To date, all the debentures issued by the IDB have been sold to the Bank of Canada, which purchases them on the basis of the Government of Canada bond yield for a comparable maturity plus an addition which is currently .60%. Debentures are issued in serial maturities ranging from one to six years on a basis which maintains approximately the same amount outstanding in each maturity.

The rate of interest paid by the IDB on its debentures has fluctuated much more widely than the IDB's lending rate, as shown in the following table:-

During	Average Interest Rate on New Loans Made	Average Interest Rate on New Debentures Issued	Spread
Fiscal - 1955	6.00%.	2.34%	3.66%
1956	6.04	3.35	2.69
1957	6.50	4.55	1.95
1958	6.00	3.79	2.21
1959	6.34	4.81	1.53
1960	6.96	5.33	1.63
1961	6.50	4.71	1.79
1962	6.54	4.90	1.64
Fiscal 1962			
First Half	6.50	4.40	2.10
Second Half	6.58	5.40	1.18

The great increase in the proportion of the Bank's resources obtained by the issue of debentures, and the size of the spread between the cost of IDB debentures and the IDB's lending rate, have been factors of growing importance in determining the net income of the Bank in recent years. In 1955 outstanding debentures accounted for only 22% of the Bank's total financial resources. At the end of fiscal 1962 this proportion had risen to 70% and interest-free sources of funds (paid-up capital, reserve fund and reserve for losses) had declined to 30% of the total. By the time the full borrowing authority provided under the amended legislation of 1961 has been used the ratio of debentures to total resources will have risen to more than 80%.

This continuing shift in the source of

the Bank's funds has already had a very marked effect on the average cost of money to the IDB. Until the Bank began to issue debentures in 1951 its cost of money was nil. In fiscal 1956 the average cost of funds was .68% per annum and in the final quarter of fiscal 1962 it was 3.23% per annum.

H - Income and Expenses

Statements of Income and Expenses and of Profit and Loss for each fiscal year from 1945 to 1962 are set out in Tables 2 and 3.

The income of the Bank continues to be almost entirely interest on loans; other income was about 3% of the total in fiscal 1962.

The main categories of operating expenses are shown below as a percentage of income:

	1955	1956	1957	1958	1959	1960	1961	1962
Debenture interest	14%	12%	26%	33%	34%	38%	41%	46%
Salaries and related expenses	25	24	23	20	20	22	27	30
Leased premises - rental and other costs	2	3	3	3	3	3	4	4
Other expenses	5	5	5	4	5	6	7	8
Net profit (before loss provision)	54	56	44	41	38	31	22	12
	100%	100%	100%	100%	100%	100%	100%	100%

The most notable feature of the above figures is the extent to which debenture interest has increased in importance as an element of the Bank's expenses - from 12% of income in 1956 to 46% in 1962 - for reasons discussed in the preceding section.

Staff salaries and related expenses (contributions to pension fund and group insurance) are the second largest expense category. Salary expenses represented 25% of income in 1955; this dropped to 20% in 1958 and 1959 and rose again to 30% in 1962. Because IDB loans are not drawn and thus do not contribute to

IDB interest income until some time after the relative investigation expenses have been incurred there is in any period of important growth in lending an unavoidable lag of income behind expenses. This has been particularly true over the last three years when the growth of lending and the necessary growth in staff has been so rapid that, as mentioned in Section F, it has involved a temporary but substantial reduction in the average level of experience of the staff. Between fiscal 1959 and fiscal 1962 the number of loan authorizations increased by 241% and the average number on the staff increased by 151% while interest income increased by 73%. By the final quarter of fiscal 1962, however, interest income was running at a rate 101% higher than in fiscal 1959.

As shown in the table above, net profit (before the annual provision for bad and doubtful accounts) has declined steadily as a percentage of income since fiscal 1956. During the last three years, under the influence of the temporary increase in the ratio of staff expenditures to income which has been mentioned in the preceding paragraph, net profits have declined in actual dollar amount. The relationship between the cost of borrowed funds, other operating expenses, and net profit before loss provision, each expressed as a percentage of average loans and investments, is shown in Table 4.

Provision for bad and doubtful debts

During the five fiscal years 1958 to

[illegible]

[illegible]

1962 inclusive the annual provision for bad debts has ranged from $444,000 to $715,000 and averaged $575,000.

In the eighteen years to the end of fiscal 1962 net write-offs of loans and investments have amounted to $1,681,000 and a reserve for further possible losses of $3,000,000 has been built up.

Net write-offs during the eighteen years represent .47% of the total amount of $360 million disbursed by the Bank on loans and investments during that period. Including the reserve for possible losses, the total provision for bad and doubtful debts has amounted to 1.30% of total disbursements on loans and investments during the eighteen year period.

I - STATISTICAL TABLES

1. Statement of Assets and Liabilities
2. Statement of Expenses
3. Statement of Income and Profit and Loss
4. Income, Operating Costs and Net Profit as a Percentage of Loans and Investments
5. Reserve for Losses
6. Sources and Cost of Financing
7. Loans on Books at Fiscal Year End
8. Loan Approvals, New and Existing Borrowers
9. Loans and Investments
10. Loan Approvals - Industrial Classification
11. Loan Approvals - Size Classification
12. Loan Approvals - Provincial Distribution
13. Average Original Period of Repayment
14. Investments
15. Guarantees
16. Personnel and Branches

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Table 1

INDUSTRIAL DEVELOPMENT BANK
STATEMENT OF ASSETS AND LIABILITIES
AS AT SEPTEMBER 30
(Thousands of Dollars)

	1945	1946	1947	1948	1949	1950	1951	1952	1953
ASSETS									
Cash on Hand and Deposits With Other Banks	204	31	38	33	41	244	67	71	110
Government of Canada Securities at Values Not Exceeding Market	8,948	10,151	14,130	8,224	6,230	5,104	-	-	-
Accrued Interest on Government of Canada Securities	69	82	104	71	51	63	-	-	-
Loans and Investments	872	5,123	11,530	17,536	20,316	21,939	29,198	33,387	38,925
Accrued Interest	6	61	138	187	257	229	308	310	267
Property Held for Sale (including Agreements for Sale)	-	-	-	-	31	36	37	59	57
Guarantees and Underwriting Agreements (as per contra)	-	-	1,800	3,080	3,260	3,406	227	243	280
Unamortized Discount and Premium on Debentures	-	-	-	-	-	-	-	7	115
Other Assets	7	12	17	40	38	40	25	23	21
	10,106	15,460	27,757	29,171	30,224	31,061	29,862	34,100	39,775
LIABILITIES									
Capital	10,000	15,000	25,000	25,000	25,000	25,000	25,000	25,000	25,000
Reserve Fund	98	439	749	784	1,516	2,218	2,881	3,688	4,534
Reserve for Losses	-	-	200	300	400	400	400	500	700
Bonds and Debentures Outstanding	-	-	-	-	-	-	1,250	3,850	8,950
Accrued Interest Due on Debentures	-	-	-	-	-	-	14	45	113
Liabilities under Guarantees and Underwriting Agreements	-	-	1,800	3,080	3,260	3,406	228	243	280
Other Liabilities	8	21	8	7	48	37	89	774	198
	10,106	15,460	27,757	29,171	30,224	31,061	29,862	34,100	39,775

	1954	1955	1956	1957	1958	1959	1960	1961	1962
ASSETS									
Cash on Hand and Deposits With Other Banks	226	32	27	350	122	377	1,453	62	
Government of Canada Securities at Values Not Exceeding Market	-	-	-	-	-	-	499	-	
Loans and Investments	42,139	44,050	52,184	71,874	88,843	96,872	103,072	123,261	165,000
Accrued Interest	289	312	351	473	436	390	452	531	
Property Held for Sale (including Agreements for Sale)	177	203	170	170	135	131	288	196	
Guarantees and Underwriting Agreements (as per contra)	135	1,321	113	56	21	18	54	47	
Unamortized Discount and Premium on Debentures	93	16	189	818	734	801	882	701	
Other Assets	26	23	29	45	89	153	145	214	
	43,085	45,957	53,063	73,786	90,380	98,742	106,845	125,012	
LIABILITIES									
Capital	25,000	25,000	25,000	25,000	25,000	25,000	25,000	26,000	30,000
Reserve Fund	6,223	7,384	8,707	10,041	11,275	12,809	14,317	15,510	16,200
Reserve for Losses	700	700	900	1,100	1,700	1,600	2,500	2,700	3,000
Bonds and Debentures Outstanding	10,700	9,500	17,700	35,450	51,000	57,700	63,600	78,900	115,300
Accrued Interest Due on Debentures	150	129	213	582	800	991	1,204	1,672	
Liabilities under Guarantees and Underwriting Agreements	135	1,321	113	56	21	18	54	47	
Other Liabilities	177	1,923	430	1,557	584	624	170	183	
	43,085	45,957	53,063	73,786	90,380	98,742	106,845	125,012	

Table I

INDUSTRIAL DEVELOPMENT BANK
STATEMENT OF EXPENSES
FISCAL YEARS ENDING SEPTEMBER 30
(Thousands of Dollars)

	1945	1946	1947	1948	1949	1950	1951	1952	1953
EXPENSES									
Salaries	68	128	203	265	337	366	400	419	417
Contributions to Pension Fund, Unemployment Insurance, Group Insurance	4	9	18	34	42	46	52	54	54
Investigation and Supervision Expenses	6	11	14	15	17	17	15	17	14
Staff Transfer and Travel Expenses	7	3	9	10	5	5	9	5	4
Rental and Other Costs - Leased Premises	1	12	12	30	33	44	52	47	48
Depreciation on Equipment	-	2	3	5	5	6	7	7	7
Telephones and Telegrams	-	3	5	8	8	8	13	14	14
Office Supplies and Expenses	4	4	8	12	12	13	9	8	8
Directors' Fees	6	4	4	4	4	4	5	5	4
Auditors' Fees and Expenses	2	4	6	6	6	6	6	6	6
All Other Operating Expenses	13	5	7	10	8	16	21	16	17
	111	185	289	399	477	531	589	598	593
Debenture Interest (incl. Amortization of Disc. and Prem.)	-	-	-	-	-	-	3	79	201
TOTAL EXPENSES	111	185	289	399	477	531	592	677	794

	1954	1955	1956	1957	1958	1959	1960	1961	1962
EXPENSES									
Salaries	502	497	570	718	831	1,039	1,313	1,813	2,700
Contributions to Pension Fund, Unemployment Insurance, Group Insurance	76	67	81	93	111	135	105	153	200
Investigation and Supervision Expenses	15	16	17	23	26	31	39	50	
Staff Transfer and Travel Expenses	17	15	27	32	16	71	65	76	
Rental and Other Costs - Leased Premises	49	51	74	109	123	157	183	306	400
Depreciation on Equipment	9	7	9	12	14	19	27	39	
Telephones and Telegrams	14	14	16	20	23	31	41	53	
Office Supplies and Expenses	15	11	15	23	25	50	102	100	
Directors' Fees	6	5	5	6	7	6	5	8	
Auditors' Fees and Expenses	9	9	9	11	11	10	20	15	
All Other Operating Expenses	22	32	37	47	54	85	93	166	
	734	724	860	1,094	1,241	1,634	1,993	2,779	4,100
Debenture Interest (incl. Amortization of Disc. and Prem.)	359	306	321	920	1,524	2,001	2,474	3,008	4,500
TOTAL EXPENSES	1,093	1,030	1,181	2,014	2,765	3,635	4,467	5,787	8,600

Table 2

INDUSTRIAL DEVELOPMENT BANK
STATEMENT OF INCOME AND PROFIT AND LOSS
FISCAL YEARS ENDING SEPTEMBER 30
(Thousands of Dollars)

	1945	1946	1947	1948	1949	1950	1951	1952	1953
INCOME									
Interest on Loans	11	138	401	697	913	1,039	1,238	1,567	1,845
Interest on Government Securities	207	195	210	294	184	149	47	-	-
Profit or Loss (-) on Government Securities	91	94	187	-149	-67	-70	-60	-	-
Commission on Guarantees	-	-	-	42	55	57	16	3	4
Commitment Fees	-	-	-	1	1	-	-	2	5
Prepayment Fees	-	-	-	-	33	2	12	9	10
Standby Fees	-	-	-	-	-	-	-	4	-
Dividends Received	-	-	-	8	7	6	2	-	-
Miscellaneous	-	-	-	-	-	6	3	1	1
TOTAL INCOME	309	427	798	893	1,126	1,189	1,258	1,586	1,865
TOTAL EXPENSES	111	185	289	399	477	531	592	677	794
NET PROFIT	198	242	509	494	649	658	666	909	1,071
of which:									
Appropriated to Reserve for Losses	-	-	200	134	133	66	3	102	225
Provision for Other Contingencies (1)	100	-100	-	326	-216	-110	-	-	-
Transferred to Reserve Fund	98	342	309	34	732	702	663	807	846

	1954	1955	1956	1957	1958	1959	1960	1961	1962
INCOME									
Interest on Loans	2,082	2,188	2,553	3,481	4,516	5,477	6,301	7,134	9,500
Interest on Government Securities	-	-	1	-	-	-	-	-	
Commission on Guarantees	4	3	13	2	1	-	1	1	
Commitment Fees	3	2	1	11	11	5	13	11	
Prepayment Fees	14	25	119	18	12	56	37	89	(
Standby Fees	-	1	7	65	113	83	64	74	(300
Dividends Received	1	3	4	6	4	3	1	1	(
Profit on Sale of Assets (2)	805	-	-	-	3	258	47	128	
Miscellaneous	26	7	5	18	3	2	-	- 14	
TOTAL INCOME	2,935	2,229	2,703	3,601	4,663	5,884	6,464	7,424	9,800
TOTAL EXPENSES	1,093	1,030	1,181	2,014	2,765	3,635	4,467	5,787	8,600
NET PROFIT	1,842	1,199	1,522	1,587	1,898	2,249	1,997	1,637	1,200
of which:									
Appropriated to Reserve for Losses	154	37	200	253	663	715	488	444	) 1,200
Transferred to Reserve Fund	1,688	1,162	1,322	1,334	1,235	1,534	1,509	1,193	)

(1) Contingency reserve set aside in 1945 was transferred to Reserve Fund in 1946. Reduction of book value of Government securities in 1948 was reversed in 1949 and 1950.

(2) These amounts were almost entirely due to profit on sale of equities relating to three customer accounts.

Table 3

Table 4

INDUSTRIAL DEVELOPMENT BANK
INCOME, OPERATING COSTS AND NET PROFIT AS A PERCENTAGE OF LOANS AND INVESTMENTS

	1945	1946	1947	1948	1949	1950	1951	1952	1953
Percentage of Average Loans and Investments									
Cost of Borrowed Money	-	-	-	-	-	-	.01%	.25%	.54%
Other Operating Expenses	1.12%	1.77%	1.77%	1.55%	1.82%	1.98%	2.11	1.90	1.61
Profit Before Provision for Losses	2.00	2.32	3.11	1.93	2.48	2.44	2.39	2.88	2.90
Total Income	3.12%	4.09%	4.88%	3.48%	4.30%	4.42%	4.51%	5.03%	5.05%
Loans and Investments Outstanding Including Holdings of Govt. Securities (Month End Averages in Thousands of Dollars)	9,901	10,444	16,336	25,632	26,154	26,924	27,852	31,514	36,934
	1954	**1955**	**1956**	**1957**	**1958**	**1959**	**1960**	**1961**	**1962**
Percentage of Average Loans and Investments									
Cost of Borrowed Money	.87%	.73%	.68%	1.45%	1.92%	2.13%	2.45%	2.68%	3.07%
Other Operating Expenses	1.79	1.74	1.82	1.73	1.56	1.74	1.98	2.47	2.79
Profit Before Provision for Losses	4.49	2.87	3.22	2.51	2.39	2.40	1.98	1.46	.82
Total Income	7.15%	5.34%	5.72%	5.69%	5.87%	6.27%	6.41%	6.61%	6.68%
Loans and Investments Outstanding Including Holdings of Govt. Securities (Month End Averages in Thousands of Dollars)	41,024	41,724	47,231	63,326	79,383	93,905	100,779	112,381	146,675

Table 4

Table 5

INDUSTRIAL DEVELOPMENT BANK
RESERVE FOR LOSSES
FISCAL YEARS ENDING SEPTEMBER 30
(Thousands of Dollars)

	1945	1946	1947	1948	1949	1950	1951	1952	1953
Opening Balance	-	-	-	200	300	400	400	400	500
Add:									
Recovery of Amounts Previously Written Off	-	-	-	-	-	-	-	-	3
Provision for Bad and Doubtful Debts for the Year	-	-	200	134	133	66	3	102	225
	-	-	200	334	433	466	403	502	728
Less:									
Bad Debts Written Off	-	-	-	34	33	66	3	2	28
Closing Balance	-	-	200	300	400	400	400	500	700

	1954	1955	1956	1957	1958	1959	1960	1961	1962
Opening Balance	700	700	700	900	1,100	1,700	1,600	2,500	2,700
Add:									
Recovery of Amounts Previously Written Off	-	2	3	-	4	5	132	2	
Provision for Bad and Doubtful Debts for the Year	154	37	200	253	663	715	488	444	562
Transfer of Interest Previously Unapplied and Held in Suspense	-	-	-	-	-	-	315	-	
	854	739	903	1,153	1,767	2,420	2,535	2,946	
Less:									
Bad Debts Written Off	154	39	3	53	67	820	35	246	262
Closing Balance	700	700	900	1,100	1,700	1,600	2,500	2,700	3,000

Table 5

Table 6

INDUSTRIAL DEVELOPMENT BANK
SOURCES AND COST OF FINANCING
DURING FISCAL YEARS ENDING SEPTEMBER 30

PRINCIPAL SOURCES OF FINANCING ($000)	1945	1946	1947	1948	1949	1950	1951	1952	1953
Increase in Shares Issued	10,000	5,000	10,000	-	-	-	-	-	-
Increase in Reserve Fund	98	342	309	34	732	702	663	807	846
Increase in Reserve for Losses	-	-	200	100	100	-	-	100	200
Provision for Other Contingencies	100	-100	-	326	-216	-110	-	-	-
	10,198	5,242	10,509	460	616	592	663	907	1,046
Increase in Debentures Issued	-	-	-	-	-	-	1,250	2,600	5,100
Total	10,198	5,242	10,509	460	616	592	1,913	3,507	6,146
Average Cost on Debentures Outstanding (%)	-	-	-	-	-	-	-	2.52%	2.80%

PRINCIPAL SOURCES OF FINANCING ($000)	1954	1955	1956	1957	1958	1959	1960	1961	1962
Increase in Shares Issued	-	-	-	-	-	-	-	1,000	4,000
Increase in Reserve Fund	1,688	1,162	1,322	1,334	1,235	1,534	1,509	1,193	900
Increase in Reserve for Losses	-	-	200	200	600	-100	900	200	300
Provision for Other Contingencies									
	1,688	1,162	1,522	1,534	1,835	1,434	2,409	2,393	5,200
Increase in Debentures Issued	1,750	-1,200	8,200	17,750	15,550	6,700	5,900	15,300	36,400
Total	3,438	-38	9,722	19,284	17,385	8,134	8,309	17,693	41,600
Average Cost on Debentures Outstanding (%)	3.41%	3.5[illegible]	[illegible].54%	3.29%	3.60%	3.62%	4.06%	4.29%	4.50%

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Table 6

Table 7

INDUSTRIAL DEVELOPMENT BANK

LOANS ON BOOKS AT FISCAL YEAR END
(Thousands of Dollars)

	Amount Outstanding	Amount Undisbursed	Total Outstanding Plus Undisbursed	Number of Customers on Books
1945	973	2, 207	3, 180	80
1946	5, 123	4, 322	9, 445	205
1947	11, 444	5, 462	16, 906	322
1948	17, 229	6, 311	23, 540	404
1949	20, 116	3, 922	24, 038	438
1950	21, 780	4, 030	25, 810	490
1951	29, 068	8, 449	37, 517	551
1952	33, 243	7, 111	40, 354	584
1953	38, 678	6, 967	45, 645	632
1954	42, 041	5, 925	47, 966	660
1955	43, 895	8, 270	52, 165	692
1956	52, 030	24, 705	76, 735	819
1957	71, 718	16, 380	88, 098	1, 021
1958	88, 637	15, 494	104, 131	1, 321
1959	96, 749	12, 399	109, 148	1, 609
1960	102, 964	16, 870	119, 834	1, 966
1961	123, 138	31, 094	154, 232	2, 768
1962	165, 000	38, 000	203, 000	4, 100

Table 8

INDUSTRIAL DEVELOPMENT BANK
LOAN APPROVALS
DURING FISCAL YEARS ENDING SEPTEMBER 30

Fiscal Year	Number			Amount ($000)			Average Size of Loan Approvals ($000)
	New Borrowers	Existing Borrowers	Total	New Borrowers	Existing Borrowers	Total	
1945	97	6	103	4,085	66	4,151	40
1946	169	18	187	7,709	301	8,010	43
1947	177	37	214	10,760	946	11,706	55
1948	142	62	204	7,783	3,933	11,716	57
1949	107	46	153	6,181	1,209	7,390	48
1950	128	60	188	6,000	1,738	7,738	41
1951	128	74	202	14,705	4,129	18,834	93
1952	111	54	165	8,024	3,514	11,538	70
1953	139	79	218	10,302	2,669	12,971	60
1954	125	55	180	10,402	2,647	13,049	72
1955	145	76	221	12,739	4,723	17,462	79
1956	232	117	349	29,264	10,095	39,359	113
1957	308	93	401	25,210	4,901	30,111	75
1958	420	151	571	26,686	9,255	35,941	63
1959	438	161	599	24,150	6,429	30,579	51
1960	571	169	740	29,516	9,059	38,576	52
1961	1,070	295	1,365	53,596	17,640	71,236	52
1962	1,700	340	2,040	74,700	15,300	90,000	44
1961 -							
1st half	391	118	509	21,365	8,089	29,454	57
2nd half	679	177	856	32,231	9,551	41,782	48
1962 -							
1st half	791	147	938	35,715	7,503	43,218	46
2nd half	909	193	1,102	39,000	7,800	46,782	42

Table 9

INDUSTRIAL DEVELOPMENT BANK
LOANS AND INVESTMENTS
FISCAL YEAR ENDING SEPTEMBER 30
(Amounts in Thousands of Dollars)

	Authorizations			Cancellations		Reductions	Net Authorizations		Disbursed	Repaid (1)	Net Increase in Outstanding	Net Increase in Amount Undisbursed
	Number of Customers	Amount Loans	Amount Investments	Number of Customers	Amount	Amount	Number of Customers	Amount	Amount	Amount	Amount	
1945	97	4,151	-	17	943	9	80	3,199	993	20	+ 973	+ 2,206
1946	169	8,010	-	36	1,192	97	133	6,721	4,606	456	+ 4,150	+ 2,115
1947	177	11,706	89	41	2,004	358	136	9,433	8,284	1,876	+ 6,408	+ 1,149
1948	142	11,716	265	21	1,123	218	121	10,640	9,789	3,782	+ 6,007	+ 851
1949	107	7,390	-	21	1,206	435	86	5,749	8,140	5,361	+ 2,779	- 2,391
1950	128	7,738	-	20	1,114	126	108	6,498	6,390	4,766	+ 1,624	+ 108
1951	128	18,834	505	12	889	1,214	116	17,236	12,317	5,059	+ 7,258	+ 4,919
1952	111	11,538	15	22	2,952	1,503	89	7,098	8,935	4,746	+ 4,189	- 1,837
1953	139	12,971	103	25	1,580	325	114	11,169	11,313	5,774	+ 5,539	- 144
1954	125	13,049	-	18	1,781	818	107	10,450	11,493	8,280	+ 3,213	- 1,043
1955	145	17,462	57	19	1,454	1,045	126	15,020	12,675	10,764	+ 1,911	+ 2,345
1956	232	39,359	1	18	790	1,984	214	36,586	20,149	12,015	+ 8,134	+16,437
1957	308	30,111	250	34	4,781	1,271	274	24,309	32,636	12,946	+19,690	- 8,327
1958	420	35,941	51	40	3,175	2,539	380	30,278	31,163	14,194	+16,969	- 885
1959	438	30,579	25	52	2,887	1,450	386	26,267	29,338	21,310	+ 8,028	- 3,071
1960	571	38,576	100	65	2,982	1,400	506	34,294	29,748	23,548	+ 6,200	+ 4,546
1961	1,070	71,236	400	109	6,934	2,716	961	61,986	47,504	27,315	+20,189	+14,482
1962	1,700	90,000	25	141	6,400	2,400	1,559	81,200	74,400	32,400	+42,000	+ 6,800

(1) Includes net write-offs and transfers to property held for sale.

Table 9

INDUSTRIAL DEVELOPMENT BANK

LOAN APPROVALS

DURING FISCAL YEARS ENDING SEPTEMBER 30

(Amounts in Thousands of Dollars)

Industrial Classification	1945 Number	1945 Amount	1946 Number	1946 Amount	1947 Number	1947 Amount	1948 Number	1948 Amount	1949 Number	1949 Amount	1950 Number	1950 Amount	1951 Number	1951 Amount	1952 Number	1952 Amount	1953 Number	1953 Amount	1954 Number	1954 Amount
Manufacturing																				
1. Foods and Beverages	17	585	23	1,176	27	1,486	32	1,783	25	1,142	31	1,240	22	1,768	23	902	21	884	21	918
2. Tobacco, Tobacco Products	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
3. Rubber Products	-	-	-	-	-	-	1	25	-	-	-	-	-	-	-	-	1	50	1	50
4. Leather Products	-	-	3	218	3	130	4	408	2	42	1	80	6	202	1	30	1	275	1	100
5. Textile Products (except Clothing)	11	1,030	9	391	14	937	10	895	10	1,169	10	525	8	735	5	252	9	780	10	927
6. Clothing (Textiles and Fur)	6	265	6	427	11	1,296	9	258	8	387	8	281	13	927	6	209	12	364	12	430
7. Wood Products	14	220	30	1,250	40	1,249	34	1,547	29	923	38	2,056	37	2,623	30	1,229	37	1,648	26	1,674
8. Paper Products (including Pulp)	4	222	6	272	7	357	4	319	6	865	7	448	7	3,257	8	434	3	131	5	254
9. Printing and Allied Industries	3	32	9	352	8	278	10	751	5	72	10	308	7	238	4	85	4	131	13	712
10. Iron and Steel Products (including Machinery, Equipment)	15	678	35	1,629	41	1,313	33	1,525	22	848	23	606	31	1,436	33	1,304	38	1,220	33	3,765
11. Transportation Equipment	2	164	4	381	8	237	8	413	3	47	7	301	11	819	4	684	7	533	1	20
12. Non-Ferrous Metal Products	2	31	3	72	-	-	1	15	3	19	3	122	6	148	8	196	7	198	10	652
13. Electrical Apparatus and Supplies	2	30	2	120	2	78	5	494	1	35	1	202	7	276	9	927	9	2,132	8	503
14. Non-Metallic Mineral Products	10	356	20	972	13	317	14	509	13	446	12	515	11	658	9	573	18	646	12	1,306
15. Products of Petroleum and Coal	-	-	1	10	2	350	1	335	1	800	1	50	1	650	4	2,290	1	125	-	-
16. Chemical Products	3	100	8	146	10	2,688	7	455	6	259	-	406	12	4,578	3	1,246	7	1,581	6	241
17. Miscellaneous Mfg. Industries	9	215	9	122	7	185	12	373	8	95	3	195	5	135	3	89	20	630	7	174
18. Commercial Air Services	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2	250	8	1,199	4	271
19. Warehousing (including Refrigeration)	5	223	18	436	20	795	18	1,516	10	157	21	403	18	384	11	338	11	247	8	936
20. Other Transportation and Storage	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
21. Electric Power, Gas, Water Utilities	-	-	-	-	1	10	1	95	-	-	-	-	-	-	1	250	1	65	1	100
22. Mines (incl. Milling), Quarries, Oil Wells	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1	250	-	-	-	-
23. Construction	-	-	1	36	-	-	-	-	1	34	-	-	-	-	-	-	1	50	1	16
24. Industrial Buildings	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1	57	-	-
25. Personal Services	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
26. Forestry	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1	25	-	-
27. Wholesale Trade	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
28. Retail Trade	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
29. Education and Health Services	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
30. Recreation Services	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
31. Services to Business Management	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
32. Miscellaneous Services	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
33. Agriculture	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
34. Fishing	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
35. Communication	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	103	4,151	187	8,010	214	11,706	204	11,716	153	7,390	188	7,738	202	19,834	165	11,538	218	12,971	180	13,049

INDUSTRIAL DEVELOPMENT BANK

LOAN APPROVALS

DURING FISCAL YEARS ENDING SEPTEMBER 30

(Amounts in Thousands of Dollars)

Industrial Classification	1955		1956		1957		1958		1959		1960		1961		1962		Cumulative to Sept. 1962	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
Manufacturing																		
1. Foods and Beverages	26	1,466	44	2,958	49	2,767	97	7,076	82	4,340	93	5,447	162	8,669				
2. Tobacco, Tobacco Products	-	-	-	-	-	-	2	200	-	-	-	-	-	-				
3. Rubber Products	1	85	1	45	1	25	2	90	2	38	5	250	9	547				
4. Leather Products	1	25	4	176	1	10	4	82	5	246	2	115	15	1,026				
5. Textile Products (except Clothing)	8	837	14	769	12	1,014	18	1,726	13	621	12	489	15	933				
6. Clothing (Textiles and Fur)	11	732	17	1,107	17	428	20	737	33	1,707	25	837	49	2,585				
7. Wood Products	38	2,130	53	4,737	69	4,535	72	5,207	76	4,739	77	5,227	128	7,682				
8. Paper Products (including Pulp)	4	236	9	2,107	5	530	11	574	6	171	12	803	18	1,615				
9. Printing and Allied Products	10	398	17	641	14	386	20	1,475	26	1,194	35	1,223	60	2,466				
10. Iron and Steel Products (including Machinery, Equipment)	28	1,805	58	3,323	62	3,895	67	3,792	73	3,124	102	4,603	182	8,584				
11. Transportation Equipment	8	398	8	2,448	11	354	26	1,095	23	795	27	787	44	1,456				
12. Non-Ferrous Metal Products	7	557	13	504	9	2,710	6	147	20	1,129	16	664	29	1,151				
13. Electrical Apparatus & Supplies	7	453	19	1,618	13	848	16	962	12	546	12	531	21	2,086				
14. Non-Metallic Mineral Products	32	3,449	26	1,822	27	2,063	38	3,503	34	1,497	41	2,625	69	6,034				
15. Products of Petroleum and Coal	5	743	5	580	-	-	1	20	1	30	2	40	3	223				
16. Chemical Products	8	311	12	449	12	638	18	1,362	20	716	24	942	28	1,303				
17. Miscellaneous Mfg. Industries	8	680	8	257	17	724	13	404	16	1,102	16	868	39	1,720				
18. Commercial Air Services	11	2,313	17	11,406	13	3,742	8	158	13	891	10	598	20	908				
19. Warehousing (incl. Refrigeration)	7	694	6	1,062	10	1,407	13	951	6	479	13	1,218	14	765				
20. Other Transportation & Storage	-	-	3	280	18	1,055	30	1,353	42	1,789	61	4,012	104	5,455				
21. Electric Power, Gas, Water Utilities	-	-	-	-	-	-	-	-	-	-	-	-	-	-				
22. Mines (Incl. Milling), Quarries, Oil Wells	-	-	3	2,525	3	525	13	1,603	6	361	20	1,500	29	2,510				
23. Construction	1	150	5	335	13	1,024	33	1,072	37	2,275	59	2,374	143	5,957				
24. Industrial Buildings	-	-	1	25	6	714	18	1,477	13	949	12	525	27	1,152				
25. Personal Services	-	-	2	45	4	254	15	433	11	327	23	672	41	1,586				
26. Forestry	-	-	-	-	-	-	1	50	-	-	2	292	5	220				
27. Wholesale Trade	-	-	1	30	4	46	3	159	7	370	13	593	28	1,287				
28. Retail Trade	-	-	1	60	6	291	2	70	8	546	18	906	51	2,182				
29. Education and Health Services	-	-	-	-	-	-	-	-	-	-	-	-	2	85				
30. Recreation Services	-	-	-	-	1	50	-	-	-	-	-	-	1	100				
31. Services to Business Management	-	-	1	30	3	51	1	30	2	51	2	105	4	168				
32. Miscellaneous Services	-	-	1	20	1	25	3	133	8	486	4	245	17	582				
33. Agriculture	-	-	-	-	-	-	-	-	4	60	2	85	8	199				
34. Fishing	-	-	-	-	-	-	-	-	-	-	-	-	-	-				
35. Communication	-	-	-	-	-	-	-	-	-	-	-	-	-	-				
	221	17,462	349	39,359	401	30,111	571	35,941	599	30,579	740	38,576	1,365	71,236				

Table 10

Table 11

INDUSTRIAL DEVELOPMENT BANK
LOAN APPROVALS
DURING FISCAL YEARS ENDING SEPTEMBER 30
(Amounts in Thousands of Dollars)

Classification by Size	1945 Number	1945 Amount	1946 Number	1946 Amount	1947 Number	1947 Amount	1948 Number	1948 Amount	1949 Number	1949 Amount	1950 Number	1950 Amount	1951 Number	1951 Amount	1952 Number	1952 Amount	1953 Number	1953 Amount	1954 Number	1954 Amount
5,000 or Less	12	51	25	90	33	113	19	56	13	45	16	48	17	59	10	40	12	37	9	15
Over 5,000 to 25,000	48	759	85	1,150	92	1,298	83	1,166	82	1,158	97	1,493	87	1,385	74	1,079	85	1,306	61	1,041
Over 25,000 to 50,000	17	679	39	1,546	37	1,397	37	1,526	27	1,097	40	1,610	50	1,904	33	1,322	62	2,445	45	1,833
Over 50,000 to 100,000	18	1,412	17	1,370	35	2,737	36	2,685	16	1,183	19	1,500	18	1,411	30	2,302	32	2,395	31	2,452
Over 100,000 to 200,000	8	1,250	16	2,404	9	1,315	21	3,228	9	1,407	12	1,806	16	2,405	9	1,345	18	2,514	22	3,601
Over 200,000	-	-	5	1,450	8	4,846	8	3,055	6	2,500	4	1,281	14	11,670	9	5,450	9	4,274	12	4,107
Total	103	4,151	187	8,010	214	11,706	204	11,716	153	7,390	188	7,738	202	18,834	165	11,538	218	12,971	180	13,049
Average Size		40		43		55		57		48		41		93		70		60		72

Classification by Size	1955 Number	1955 Amount	1956 Number	1956 Amount	1957 Number	1957 Amount	1958 Number	1958 Amount	1959 Number	1959 Amount	1960 Number	1960 Amount	1961 Number	1961 Amount	1962 Number	1962 Amount	Cumulative to Sept. 1962 Number	Cumulative to Sept. 1962 Amount
5,000 or Less	9	20	13	31	13	31	20	52	31	105	28	121	39	165				
Over 5,000 to 25,000	76	1,239	119	1,971	143	2,392	223	3,662	242	3,911	313	4,905	578	8,960				
Over 25,000 to 50,000	52	1,892	80	3,014	92	3,599	127	4,947	153	5,939	188	7,131	372	14,238				
Over 50,000 to 100,000	42	3,184	72	5,425	88	6,582	121	9,047	112	8,406	124	9,659	234	17,610				
Over 100,000 to 200,000	24	3,498	32	4,820	36	5,526	46	6,808	43	6,293	60	8,748	105	15,418				
Over 200,000	18	7,629	33	24,098	29	11,981	34	11,425	18	5,925	27	8,012	37	14,845				
Total	221	17,462	349	39,359	401	30,111	571	35,941	599	30,579	740	38,576	1,365	71,236				
Average Size		79		113		75		63		51		52		52				

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Table 11

Table 12

INDUSTRIAL DEVELOPMENT BANK
LOAN APPROVALS
DURING FISCAL YEARS ENDING SEPTEMBER 30
(Amounts in Thousands of Dollars)

Classification by Province	1945		1946		1947		1948		1949		1950		1951		1952		1953		1954	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
Newfoundland	-	-	-	-	-	-	-	-	-	-	1	150	1	425	1	250	-	-	1	145
Prince Edward Island	-	-	-	-	-	-	2	39	2	21	1	11	-	-	4	41	-	-	-	-
Nova Scotia	3	140	4	295	6	188	9	274	3	126	6	103	4	122	2	28	4	188	-	-
New Brunswick	4	235	1	80	9	385	9	296	10	158	10	561	11	275	11	365	8	175	1	30
Quebec	35	1,502	65	3,380	55	4,103	61	4,006	51	3,346	64	2,659	79	8,990	58	3,837	80	4,844	55	3,515
Ontario	40	1,517	79	2,930	71	3,868	68	3,337	38	1,455	51	2,278	41	5,024	34	1,872	58	3,328	70	5,318
Manitoba	5	342	8	157	20	646	15	550	7	294	5	108	14	304	16	398	14	777	8	378
Saskatchewan	2	30	3	68	4	85	3	32	2	820	9	122	9	1,230	6	2,079	5	110	4	245
Alberta	7	247	7	627	19	1,195	6	467	13	397	11	346	8	119	8	1,578	21	2,047	8	931
British Columbia	7	138	20	473	30	1,236	31	2,715	27	773	30	1,400	35	2,345	25	1,090	27	1,442	30	2,341
Yukon, N.W. Territories	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1	60	3	146
Total	103	4,151	187	8,010	214	11,706	204	11,716	153	7,390	188	7,738	202	18,834	165	11,538	218	12,971	180	13,049

	1955		1956		1957		1958		1959		1960		1961		1962		Cumulative to Sept. 1962	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
Newfoundland	-	-	2	75	2	255	2	31	7	235	8	698	21	754				
Prince Edward Island	-	-	5	5,498	1	10	-	-	5	171	8	111	4	70				
Nova Scotia	4	252	7	393	15	1,060	28	1,235	32	1,355	28	1,075	49	2,130				
New Brunswick	7	206	8	1,344	20	1,236	24	1,399	27	765	30	888	61	2,711				
Quebec	71	5,246	96	11,903	98	7,140	147	10,449	140	7,585	147	9,398	259	16,914				
Ontario	61	5,638	121	9,118	129	9,079	169	10,473	193	9,862	264	12,388	538	25,047				
Manitoba	14	790	22	2,504	19	1,344	42	2,050	32	2,065	37	1,895	106	5,433				
Saskatchewan	6	465	1	10	7	858	11	1,019	19	978	28	1,493	64	3,133				
Alberta	14	694	25	2,232	28	1,621	58	2,796	56	2,745	76	3,465	131	5,990				
British Columbia	43	4,091	60	6,181	80	6,933	89	6,239	86	4,743	110	7,057	127	8,907				
Yukon, N.W. Territories	1	80	2	101	2	575	1	250	2	75	4	108	5	147				
Total	221	17,462	349	39,359	401	30,111	571	35,941	599	30,579	740	38,576	1,365	71,236				

Table 12

Table 13

INDUSTRIAL DEVELOPMENT BANK

LOAN APPROVALS - AVERAGE ORIGINAL PERIOD OF REPAYMENT

During Fiscal Years Ending September 30

	Average Original Period of Repayment	Average Period From Date of Authorization to First Repayment
1950	65.1 months	7.4 months
1955	76.8	6.4
1960	68.5	4.7
1961	76.3	4.8
1962	81.4	4.9

Table 14

INDUSTRIAL DEVELOPMENT BANK
INVESTMENTS
(Amounts in Thousands of Dollars)

Fiscal Year	Authorizations During Fiscal Year		Outstanding at End of Fiscal Year	
	Number	Amount	Number	Amount
1945	-	-	-	-
1946	-	-	-	-
1947	3	89	3	87
1948	3	265	6	308
1949	2	-	6	199
1950	-	-	4	159
1951	2	505	4	130
1952	1	15	5	145
1953	3	103	8	247
1954	2	-	8	98
1955	3	57	11	154
1956	2	1	12	154
1957	2	250	14	156
1958	1	51	15	207
1959	1	25	9	123
1960	1	100	5	108
1961	2	400	5	123
1962	2	25	5	273

Table 15

INDUSTRIAL DEVELOPMENT BANK

GUARANTEES
(Amounts in Thousands of Dollars)

Fiscal Year	Guarantees Approved During Fiscal Year		Guarantees Outstanding at End of Fiscal Year	
	No.	Amount	No.	Amount
1945	-	-	-	-
1946	-	-	-	-
1947	2	3,005	1	1,800
1948	4	211	5	3,081
1949	7	265	8	3,260
1950	8	255	13	3,406
1951	2	25	8	228
1952	2	30	9	243
1953	2	80	8	280
1954	2	55	5	135
1955	3	1,158	8	1,321
1956	1	8	5	113
1957	-	-	4	56
1958	2	17	1	21
1959	-	-	1	18
1960	2	41	3	54
1961	4	63	3	47
1962	-	-	1	14

Table 16

INDUSTRIAL DEVELOPMENT BANK
PERSONNEL AND BRANCHES

Number of employees at fiscal year end	1945	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Male	13	27	38	48	52	54	52	48	47	50	52	66	75	89	109	144	233	268
Female	13	17	32	44	47	46	40	45	44	43	47	53	60	73	84	107	169	204
Total	26	44	70	92	99	100	92	93	91	93	99	119	135	162	193	251	402	472
Number of branches at fiscal year end	3	4	4	4	4	4	4	4	4	4	4	6	6	6	10	13	16	22

OPENING DATES OF BRANCHES

Montreal	Nov. 1944	Ottawa	May 1960
Toronto	Feb. 1945	Sudbury	May 1960
Vancouver	May 1945	Edmonton	Sept. 1960
Winnipeg	Oct. 1946	Hamilton	Sept. 1961
		Lakehead	Sept. 1961
Halifax	June 1956	St. John's	Sept. 1961
Calgary	July 1956	Saskatoon	Apr. 1962
		Victoria	June 1962
Saint John	Apr. 1959	Waterloo	June 1962
London	June 1959	Moncton	June 1962
Quebec City	June 1959	Three Rivers	June 1962
Regina	Sept. 1959	Kelowna	Sept. 1962

Table 16

Royal Commission on Banking and Finance

GOVERNMENT OF THE PROVINCE OF
QUEBEC
(ENGLISH)

Hearings held at

(BRIEF)

Vol. Date.

60A ———

Official Reporters
F.J. Nethercut and R.J. Young
Toronto, Ont.

Royal Commission
on
Banking and Finance

GOVERNMENT OF THE PROVINCE OF
QUEBEC
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held at

(BRIEF)

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F.J. Nethercut and R.J. Young
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R O Y A L   C O M M I S S I O N
ON
B A N K I N G   A N D   F I N A N C E

A SUBMISSION

by the

GOVERNMENT OF QUEBEC

QUEBEC, February, 1963

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INTRODUCTION

1. In recent years the rate of growth of the national economy has significantly declined (1). Not without reason this downturn of economic activity has alarmed both those in government and the public at large. Apart from other measures, an appraisal of Canada's financial structure has therefore become imperative: we are gratified that the work of your Commission comes at so appropriate a time. We are convinced that your studies will illuminate existing deficiencies in the financial system and will, as a consequence, lead to measures to improve the system for the benefit of all.

2. We hope, moreover, that the Commission will be able to use this opportunity to examine the efficiency of the various techniques of monetary policy, and to recommend those means that are most appropriate to the development of the national economy and the balanced growth of regional economies.

3. Actually, we feel that the monetary and financial system should be capable of adequately serving all sectors of the national economy, and not only particular economic regions or certain levels of government.

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(1) From 1954 to 1957, gross national expenditures, in 1949 dollars, have increased by about $4 billion. From 1958 to 1961, they have increased by $1.7 billion. In the first period, the unemployment rate has varied from 3.4% to 4.6%. In the second period, the average stood between 6% and 7.2%.

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The system should be organized and directed so that through monetary and financial techniques the human and physical resources of the country are of maximum benefit to the welfare of the population as a whole, without detriment to any of its component parts.

4. With this in mind, we respectfully submit the following information and comments.

We first present a picture of the principal financial objectives of the Provincial Government and of its municipal administrations. This is followed by comments on the means by which the realization of these objectives can be facilitated by the monetary policy of the Government of Canada.

We next describe the methods hitherto used by the Government of Quebec to obtain needed funds. Finally, after some comments on present methods of financing, we suggest a number of modifications.

- CHAPTER I -

THE OBJECTIVES OF THE GOVERNMENT OF THE PROVINCE OF QUEBEC

5. One of the main concerns of our Government is to ensure the economic expansion of the Province of Quebec. Since we are aware of the direct interrelationship which exists between this expansion and government activity, a large part of our programme rests on the development of Quebec's economic potential. We intend to facilitate the creation of the infrastructure necessary to ensure the growth of productive capacity in the private

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sector to a level of activity as close as possible to the full growth potential of the whole economy. (2) We believe that the implementation of our government's projects, described in the chapter which follows, is necessary to attain this objective. Our task in this field is immense; its urgency and its necessity are no longer in doubt.

6. The interest of our Government with regard to the economic development and expansion matches the preoccupation of most other governments. Although the control of economic cycles and the maintenance of a stable course of prices and production fall within the responsibilities of the central government, these stabilizing functions no longer retain the urgency or the priority which they had in the recent past. It is generally recognized that in the present juncture public investment must have as its prime objective a rate of economic growth that if not accelerated is at least stable.

7. The central Government surely plays an important role in economic development, but it is also true that the Provinces have in this respect a very important task to fulfill. The reason is a simple one. According to the Canadian Constitution the immediate elements of economic growth, namely, the development of human and natural resources, come within provincial jurisdiction.

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(2) Here the question is the use of measures appropriate to ensure maximum growth, that is, to improve the economic infrastructure. This improvement will certainly play an important role in the adequate utilization of man-power. But it would not be sufficient without the assistance of

the monetary and fiscal policies of the Federal Government. In Chapter III will be found a discussion of full employment and the federal policies in this regard.

8. In this sense, the priority to be given the projects of our Government is unquestionable. In various periods in the past other projects had, of necessity, higher claims than those of the Provinces, more particularly during the war and the immediate post-war when the central Government had to assume heavy responsibilities. In the present state of affairs, however, provincial requirements resume a priority temporarily abandoned. It follows that particular attention must now be given to the operations of financial institutions and to monetary policy generally, so that their functioning does not prejudice the legitimate activities of provincial governments.

9. Even more, it seems to us that everything should be done to assure that financial shortages do not prevent the provinces from meeting their responsibilities. Among these responsibilities, one of the most urgent is surely the necessity of improving and, where necessary, creating the infrastructure essential to the rational utilization of all economic resources. It seems indeed that this urgency is recognized by the central Government, as is proved by such things as the application of vast joint programmes of urban development and the construction of access roads to natural resources.

10. The creation of this infrastructure implies

that certain activities and projects of the Federal Government should give way to the activities of the provincial governments. We should not think, however, that this course will be detrimental to federal interests. On the contrary, the realization of provincial projects can only contribute to the expansion of the national product and thereby facilitate the financing of federal activities as well as provincial. The central Government and the country as a whole will be the beneficiaries.

11. It is with these considerations in mind that we have striven to assess the importance of our financial needs, basing this appraisal on the evolution of the expenditures and revenue of our Government.

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- CHAPTER II -

BORROWING NEEDS OF THE GOVERNMENT OF QUEBEC

12. The determination of the borrowing needs of a government is an intricate matter. Fundamentally, they are subordinate to the evolution of governmental expenditures and revenues. Expenditures are a function of the needs to be satisfied, the magnitude of which is directly related to economic choices made by the people or by those who govern them.

13. Once total requirements have been estimated, it is a question of dividing the responsibilities among the different levels of government. More often than not this division is proportioned to the financial resources of each level of government, as those resources were defined about a century ago, slightly amended owing to the two World Wars and the depression of the 'thirties. But these resources have not changed as rapidly as the expenditures entailed by the respective responsibilities of the various levels of government. (3)

14. Our argument will first be limited to presenting some specific requirements which the Government of Quebec will be called upon to satisfy in the coming years. Then we will give an idea of the financial resources available to meet them. From this comparison of financial requirements and financial resources will emerge the problem of finance.

(3) Furthermore this explains the creation of joint programmes proposed by the Federal Government. During 1961-1962 fiscal year, the revenues of the Province by virtue of these programmes stood at $164.4 millions.

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15. In the first place we must continue to provide for the traditional services: public health, education, highways, public works and social allowances; the needs for such services increase at an accelerated pace. Furthermore, we will have to assume increased responsibilities in certain sectors, as, for example, medical care and education. Finally, new responsibilities arise with particular regard to the utilization and preservation of natural resources, to water purification and to urban renovation. Lack of initiative in these fields would substantially slow our economic progress.

16. Moreover we must make good for lost time, needed services must steadily be improved, and all services must increase in order to meet the increase of the population (4). These factors as well as those mentioned in the previous paragraph must bring about an important increase in government expenditures.

17. We may explain in greater detail the evolution of expenditures in sectors where the role of the government will be preponderant. These sectors are: (a) education, (b) health, with hospital services included, (c) highways, public works and natural resources, and finally (d) urban development.

18. In the field of education, a greater number of qualified teachers will be needed, as well as more spacious and more numerous premises to meet the

(4) Natural demographic increase is mostly responsible for our population growth. Adding to this prime factor immigration, it could be said that Quebec's population now increases by about 110,000 citizens a year. It is estimated the population will stand at 5,737,000 in 1966 and at 6,380,000 in 1971.

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requirements of an increasing population. In fact the formation of better educated and better trained man-power is a prerequisite to our economic progress.

Education outlays have already considerably increased. Nevertheless, much remains to be done to fill deficiencies and to complete the system. In order to fulfill their tasks, secondary schools, colleges and normal schools have an urgent need of greater numbers of competent personnel. Moreover, our universities must be assured of sufficient means to enable them to grow in accordance with the student population and the environmental conditions. (5) Finally, the chronic deficits of the School Corporations indicate clearly that the time has come to give them revenues proportionate to their responsibilities. All these problems have become well known: our government could not delay the application of its policies to their solution. Since this is so, educational outlays per student will necessarily increase in the coming years, and total educational outlays will increase even more. In Canada, during the last ten years, provincial expenditures for educational purposes have tripled. It is our opinion that a similar increase will take place in Quebec during the next decade.

19. The vast natural resources of the Province of Quebec are known to all. It will be agreed, however,

(5) At the School Corporation level, the enrollment increase for the year 1962-1963 is estimated at 60,000 students. This gives an idea of the rate of the growing needs of new classes in that sole sector of education.

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that compared to their potential these are still mostly untapped. Their full development is one of the objectives which the Government of the Province wishes to attain.

To this end our highway system must be completed and access roads (highways and railways) to our natural resources must be opened. In the same way we expect to complete our expressway system, to improve rural roads, and to build tourist highways. It can be estimated that our expenditures in the transportation field and for public works will more than double in the next ten years. (6)

20. As to the health and social welfare sector, substantial increases in current and capital expenditures are foreseen in order to provide for the necessary services appropriate to a continually growing population. Besides, the ever increasing number of old people requires the construction of buildings of a newer type, as, for example, reception centers.

21. In the past, outlays for urban development have not been considerable. We judge, however, that

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(6) Because of the development of the natural resources of the Great North, the transportation problem in our Province is taking a dimension totally different from that of the other Provinces, and particularly that of Ontario. There are two main reasons. First of all, nothing exists in the greatest part of the territory, whereas the North and North-West of Ontario are already developed. Then, distances themselves are greater. From Toronto's industrial district to Moosonee, on the James Bay coast, the aerial distance is about 600 miles. From Montreal's industrial district to Fort Chimo in Ungava Bay, where development of important mineral deposits is undertaken, the distance is about 1,100 miles.

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this situation will be very much changed in the future. In fact the new needs created by the rapid urbanization of the population require from local administrations ever increasing services. Consequently, the costs of development of urban centers and of the application of preventive measures against deterioration will be enormous. Our responsibilities in this respect will probably become larger and larger, since the provision of urban complexes with multiple services is of fundamental importance to a society that wishes to expand. Water purification, to take a single example, will require outlays on a scale never contemplated till the present.

22. Finally, in addition to the increased outlays just mentioned, economic growth requires a parallel expansion of the traditional functions of government, in such areas as the administration of justice, aid to agriculture and fisheries, and the administration of the government itself.

23. Government spending will surely triple within ten years. This may seem a considerable increase. Actually, experience shows that the expenditures of our government have more than tripled for each of the decades beginning in the years from 1943 to 1952. From 1952 to 1962, for example, expenditures have been multiplied by a factor of about 3.4.

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federal, provincial and municipal responsibilities involves a more rapid increase of provincial and municipal outlays than of those of the federal Government. At the same time, with increases in national income, federal receipts are likely to increase more rapidly than those of the provinces, and even more so, than those of the municipalities. This situation inevitably breeds a deficit which must in some way be financed. The increase of the debt of the municipalities (7) and of the Province is already witness of this. Should the division of responsibilities and the sources of revenue remain unchanged, provincial and local governments will have to borrow larger and larger amounts in order to discharge their full responsibilities.

25. Actually, there are only two ways at our disposal to finance our expenditures: current revenues and loans. Needless to say, current outlays should be financed out of current revenues. As to investment outlays, they also should come as far as possible from current revenues, but more often than not there must be a resort to borrowing. Your Commission is especially interested in this portion of expenditures financed through loans. But since our borrowings are clearly related to the size of our revenues, it is useful to make some remarks with regard to our revenues as such.

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26. To estimate the revenue of a government is much more complex than to estimate its spending. Quebec's revenue is to a great extent subordinate to various factors about which our government cannot always take the initiative. Among other things should be mentioned the general economic situation, fiscal arrangements, and the structure of the provincial taxes and levies.

27. Essentially, provincial revenue is directly linked to the general economic situation. Though the role of our government is important as regards Quebec's economic situation, it is far from being preponderant, particularly if we have in mind that the Canadian economy itself is subordinate to factors which are totally outside its influence.

It can be admitted, however, that economic prospects are more encouraging than they were even a few months ago. It seems that the threat of recession has somewhat diminished and that production has renewed its advance. With regard to unemployment, measures should be taken so that not only will it cease to increase at the rate of recent years, but that it will be reduced to the point where all those wishing to work can find employment. But in short, everything indicates that no serious depression is in sight and that downward fluctuations will be minor and short-lived. Should these fluctuations cause temporary financial problems, appropriate monetary policy should readily solve them.

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28. In the second place, the magnitude of our revenues depends on the division of income taxes among the various levels of government. It follows that the amount of our borrowing is closely linked to the problem of fiscal relations. Though the study of this issue does not fall within the responsibilities of your Commission, we think it proper to make certain remarks on the subject, since a great part of the income of the Province depends on this question. The programme of federal subsidies should not in our opinion constitute a permanent solution to our financial problems. These subsidies are doubtless very useful in certain circumstances. But there are strong reasons for seeking alternatives which will allow the provinces to fulfill their obligations within the scope of the powers set forth for them in the Constitution.

29. In any case, it seems difficult to estimate the future importance of the revenue coming from conditional subsidies and joint programmes (8) since we are not kept informed of the federal government's intentions in these matters. It is fair to hope, however, that the central government will gradually withdraw from these programmes and transfer to the provinces the sources of revenue which subsidize their operation. The local administration of these revenues would permit various economies in their use, and so would be more efficient.

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30. We have already expressed our opinion with regard to the personal income-tax. The progressive transfer of this field of taxation to a level of 20%, even though insufficient, could have considerably eased the financial burdens of our government. However, present fiscal arrangements are formulated in such a way that we lose through a decrease of equalization grants what we gain with the increase of our share of the personal income-tax.

From these observations, it is obvious that our need for borrowed funds is intimately linked to the arrangement by which fiscal revenues are divided.

31. Finally, the volume of our revenues depends on the level and structure of provincial taxes and levies. In this respect we are able to maintain a certain initiative. We judge, however, that in present circumstances this initiative is restricted by the fact that the present level of taxes and levies already constitutes a rather heavy burden for the tax-payer, and threatens to slow down industrial expansion in the private sector of the economy. Consequently, in considering how to increase such revenues, we think chiefly of broadening the base of the income-tax through policies encouraging economic expansion. In fact, the progressive nature of our income-taxes (9) allows us to hope that as personal income grows, the yield of these taxes will

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make a major contribution to the financing of greater current services.

32. Nevertheless, this growth will not be sufficient to finance the massive investments discussed above. Even last year, the amounts requested by our various Departments to carry out the programmes for which they are responsible had to be cut by about a quarter of billion dollars. Moreover, our long run projects of economic development and social renovation could not be achieved without accelerating the pace of our investment programme, and consequently, without frequent recourse to substantial borrowing.

33. Naturally, the adoption of an indiscriminate and unlimited policy of borrowing is out of the question. As far as possible, our investments will be financed out of current revenue. But the fact remains that a great part of these investments will have to be financed through loans. Besides, even apart from the question of whether sufficient revenues exist, the principle of financing investment through loans is an accepted one. Services obtained from such investments are spread over several years: it is normal that their cost should be borne by those who profit from them. Some years ago, the Investment Dealers Association, in a submission before the Gordon Commission, recommended that capital expenditures be financed through long-term bond issues in order that their maturities be in line with the durability of the capital goods thus created.

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34. In spite of the uncertain and random nature

of the volume of loans, future totals can be roughly estimated by taking into account current values. Our experience indicates that the investments, which are generally the occasion for such loans, do not present themselves in blocks which by degrees diminish, not to rise again till some years later. Their rise is constant, though at a variety of rates. In every dynamic economy, as soon as certain capital needs are satisfied, others appear with as much urgency as the first.

35. In the fiscal year 1961-1962, estimated government borrowing was fixed at $175,000,000. In the present fiscal year, the estimate is ranging about $225,000,000. This figure includes loans necessary to make up the difference between the current account surplus and the capital outlays (about $145,000,000.) used to finance extra-budgetary expenditures like those of the Autoroute Board, and the Farm Credit Bureau, and used for the construction of university buildings, the General Investment Corporation and the redemption of matured bonds. This does not take into consideration the borrowings of Hydro-Quebec nor the cost of the nationalization of the electric power companies.

36. The direct and indirect debt of the Government of Quebec doubled between 1950 and 1960. (10) Should the same thing occur in the next ten years, the increase would amount to about $130 millions a year.

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(10) It stood at $627.1 millions in 1950 and at $1,307.9 millions in 1960; Bank of Canada, Statistical Summary Supplement, 1961.

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35. In the fiscal year 1961-1962, estimated government borrowing was fixed at $775,000,000. In the present fiscal year, the estimate is [illegible]. This figure is the amount necessary to make up the difference between the current account surplus and the capital outlay (about $345,000,000) used to finance once-for-all expenditures like those of the [illegible] and the Farm Credit Bureau, and used for the construction of university buildings, the General Investment Corporation and the redemption of matured bonds. This does not take into consideration the borrowings of Hydro-Quebec for the cost of the nationalization of the electric power companies.

36. The direct and indirect debt of the Government doubled between 1950 and 1960. (10) Should the same thing occur in the next ten years, the increase would amount to about $90 millions a year.

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(10) It stood at $897.1 millions in 1950 and at [illegible] Summary [illegible], 1961.

This figure, however, must much understate borrowing. In fact, every year, the Province would have to resort to the security market for refinancing purposes. Moreover, it should be noted that in the last ten years Quebec's relative indebtedness was lower than that of the more dynamic Canadian provinces. This past, however, stands out against the future in consequence of the determined intention of our Government to use all available means to realize its programme of economic expansion. Since the beginning of the 1950's, Ontario's net direct and indirect debt has been multiplied by 2.75, Manitoba's by 4 and British Columbia's by over 2.6. If Quebec's debt were to be increased in the same ratio as Ontario's, that is 2.75, its net annual increase would be about $225 millions.

An important distinction, however, must be mentioned with regard to the division between direct and indirect debt. The former constitutes a real burden on the budget. Ordinarily, the indirect debt is self-liquidating. For example, the debt of Hydro-Quebec, roughly $928 millions, is entirely supported by this organization, which has always had more than sufficient earnings to meet its interest and amortization requirements, and sometimes realize substantial surpluses.

From 1947 to 1960, Ontario's net funded debt, less sinking funds, rose considerably, increasing from $543.8 millions to $1,485.8. That of Quebec has remained almost stationary, increasing from $367.3

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millions in 1947, to only $408.3, in 1960. (11) This explains, in part, the accumulation of needs which must now be satisfied. Consequently, we may have to resort to loans as Ontario has done from 1945 on, in order to make up for the time lost by our predecessors.

37. Finally, it should be mentioned that to reach the amount of Ontario's present indebtedness, Quebec's direct and indirect net debt would almost double. On the assumption that the increase of Ontario's debt remains constant during the next five years, Quebec could borrow annually $200 millions more than Ontario before attaining, in 1967, a total debt of relatively comparable importance.

38. These comparisons illustrate the lag in Quebec with respect to capital investments, and emphasize the urgency of the investments we intend to carry out. They also give us an idea of the importance of the loans the government will have to make to realize its programme of economic expansion.

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(11) Bank of Canada, Statistical Summary Supplement, 1961. On March 31, 1962, the funded debt of these two provinces (according to recent figures published by the Dominion Bureau of Statistics) stood as follows:

Net funded debt	Quebec	Ontario
	In millions	
Direct	$ 496.4	$ 1,643.2
Indirect	869.6	1,564.0
Total	1,365.0	3,207.2

It is known that personal income in Quebec is about 72% of Ontario's. This percentage is the average for the years between 1953 and 1958.

millions in 195[illegible]

This explains, in part, the accumulation of needs which must now be satisfied. Consequently, we may have to resort to loans as Ontario has done from 1945 on in order to make up for the time lost by our province.

27. Finally, it should be mentioned that to reach the amount of Ontario's present indebtedness, Quebec's direct [illegible] double. On the assumption that the increase of Ontario's debt remains constant during the next five years, Quebec could borrow annually $400 millions more than Ontario before attaining, in 196[illegible], a total debt of relatively comparable importance.

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(11) Bank of Canada, Statistical [illegible] 1961. On March 31, 1961, the funded debt of these two provinces (according to recent figures published by the Dominion Bureau of Statistics) stood as follows:

Net funded debt

Direct	[illegible]	[illegible]
Indirect	[illegible]	[illegible]
Total	[illegible]	[illegible]

It is known that personal income in Quebec is about [illegible]% of Ontario's. This percentage is the average for the years between 195[illegible] and 196[illegible].

39. To the Government loans must be added those which now and later will be made by the School and Municipal Corporations, and by the Crown corporations, despite the imposing subsidies of the Government of Quebec to some of these public bodies. In the coming years these public bodies will have to resort more and more to the financial market in order to provide for their investment needs.

40. From January 1, 1962, to December 31, 1966, Hydro-Quebec is considering capital expenditures of about a billion dollars. This amount does not take into consideration the nationalization of the power companies. Part of these expenditures will be the result of the harnessing of the Manicouagan and Outardes rivers. These projects will not be completed for 15 years. Once completed, it is estimated that they will have cost about $1,400,000,000.

It is true that a good part of these expenditures will be financed out of the Commission's current earnings. It remains true, however, that important amounts will have to be raised by issuing bonds. Thus, Hydro-Quebec considers borrowing $97.5 millions this year and $195 millions in both 1964 and 1965. After that, the amount of its borrowing will be significantly reduced. (See appendix, Table I).

We have not yet mentioned the outlays incurred by the nationalization of the hydro electric power companies. On last December 28, the Prime Minister announced the decision of the Quebec Hydro-Electric Commission, with the approval of the Government,

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to make firm and final offers to the shareholders of the electric power companies, the nationalization of which had been decided. The approximate total cost of the nationalization as reflected in the offers is as follows: par value of bonds of the companies (after amortization) in 1962, $247,000,000; par value of bonds offered to preferred shareholders, $53,000,000; cash payments to be made to common shareholders, $303,000,000.

41. As to School and Municipal Corporations, their indebtedness continues to increase at a rapid rate. It has almost doubled from 1956 till 1961, rising from about $880,000,000. to $1,600,000,000. (12) In 1961, the two public bodies borrowed a total amount of $235,000,000. They borrowed a slightly larger amount in 1962.

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(12) Bank of Canada, Statistical Summary Supplement, 1961.

[illegible]

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- CHAPTER III -

FINANCIAL PROGRAMMES OF THE FEDERAL GOVERNMENT

Impact On The General Economy Of The Province

42. In speaking of the financial programmes of the federal government we have in mind those programmes broadly considered, and intend to refer not only to the fiscal policy of the government but to such things as its dealings in foreign exchange and its responsibility for the monetary operations of the Bank of Canada. On that understanding it is a commonplace to say that federal programmes strongly influence the national income, having much to do with the composition of the income and the way it is distributed, and having a still more powerful effect upon its total size. We may even say that these programmes very largely determine how large the national income shall be, and, as a consequence, very largely determine the totals of employment and unemployment in the labour force.

43. This does not mean that the national income can be anything the federal authorities choose to make it. Technology and natural resources set outer limits to what the economy can do. Nor does it mean that the national income is largely created or provided by the federal authorities. The contributors to the national income include not only the other levels of government, provincial and local, but also the vast array of those who constitute the private sector. The influence of the federal finances on income and employment turns upon their compensatory character. In the rest of the economy variations of a random or cyclical kind are

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still experienced, and still pose urgent problems of waste and inefficiency. The system of federal finances is such that it contains both the power and the responsibility to compensate for these variations.

It would over-simplify matters to say that compensatory action at the federal level can ever be complete or exact. It would also over-simplify matters to say that there is no responsibility for compensating policies elsewhere, and no devices by which other sectors can contribute to full employment and stability. We are indeed anxious to discuss all proposals directed to the timing and co-ordination of provincial activities in the interest of overall stability. But it is still true that compensatory intervention in the economy must be predominantly a federal responsibility. Both the federal and the provincial governments have their specific duties in providing economic services in the ordinary way, that is, in providing services needed for their own sake and on a continuous basis. But deliberate expansion to take up slack, and deliberate contraction to offset excessive spending, these things must chiefly originate in the federal sphere. This is in the nature of the modern economy. There is no couterpart in provincial government to the federal government's flexibility in using budget deficits or surpluses to stabilize spending, in using the market for foreign exchange to affect exchange rates, in using the Bank of Canada to determine the stock of money and the structure of interest rates.

44. The success or failure of federal programmes

to maintain employment and stability has therefore the greatest importance to the provincial economy. Serious failure on the part of the federal authorities is probably beyond the provincial power to repair. The fact that Canada is an open economy, heavily dependent on exports and imports for its economic well being, adds greatly to the problems faced by the federal government. But any province considered by itself is, of course, in enormously greater degree an open economy than is the country as a whole, and is an open economy without the monetary and fiscal instruments that give the country as a whole some independence of outside events. The general economy of Quebec, its level of production, the revenue its taxes produce, the speed at which its backlog of social capital can be made good, the attraction it presents to foreign investors, these things are greatly enhanced or prejudiced as the federal authorities meet or fall short of the goal of stable full employment. The interest of the Province in programmes that affect it so greatly but that are largely outside its control is naturally intense.

45. We are well aware of the dilemma with which policy makers in this field expect to be confronted. On the whole, to spend more or to encourage others to spend more is an incentive to production and so to employment. At the same time a programme of spending is very unlikely to lower prices, but either leaves them more or less unchanged, or after a time tends to raise them: if spending is indefinitely increased it must eventually raise prices because there is a limit

to the production on which it can be spent. Eventual inflation may then redistribute income in an unsatisfactory way, may also produce inefficiency in the domestic economy, and, by discouraging exports and encouraging imports, may also produce inefficiency in relation to the international economy. Evidently only the ignorant or the opportunistic would advocate the expansion of spending without regard to its amount or on the basis of some mechanical formula that is heedless of rapid inflation.

46. Heavy unemployment leads to the prescription that spending should be created or encouraged by the federal authorities. With excess capacity prices are likely to remain as they were, so that the prescription has at first few undesirable side effects. But as heavy unemployment is reduced to mild unemployment excess capacity is also diminished, and extra spending perhaps reflects itself not only in higher output but in higher prices. And if full employment should be reached, so that excess capacity has virtually vanished, then the tendency to higher prices will be strengthened and full blown inflation will appear. The dilemma for the policy-maker is found in the doubtful middle ground.

47. It is a question on which there should hardly be a provincial view that is in any way different from the federal view. Yet as is well known over a period of several years we have experienced continuing unemployment on a substantial scale. In 1961, the average percentage was 7.2, the highest annual figure for the post-war period. Last year, even if this percentage

was lower, it was still as high as 5.9%. (13) If against these figures it could be said that the standard remedies have been tried but have failed, then it would be necessary to look for new remedies and to rethink the whole problem once again. But in fact throughout this period interest rates, although fluctuating a certain amount, have remained dramatically higher than in the first decade after the war. We have experienced an extended period in which unemployment has been high, and yet in which one of the classical remedies for unemployment, low interest rates, has not been applied.

48. The federal fiscal and monetary authorities must always have been aware of the dilemma we have just outlined. Indeed the theory, as we have expressed it, is in elementary and even naive form, as the Commission well knows from analyses of a more technical kind. Why then should high levels of unemployment and high interest rates have been allowed to persist side by side? It must have been the case that the federal authorities felt that they were in that middle ground where the benefits of further expansion would be offset by losses to be attributed to inflation or the prospect of inflation.

49. Yet in the event this has surely proved to be a grievously mistaken estimate. On the one hand there has been no need to conjecture about the fact of unemployment. It has been before our eyes. Associated with unemployment there has inevitably been the waste of

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(13) Labour Force, Dominion Bureau of Statistics.

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all the extra goods and services a fully employed economy might have produced. On the other hand the possibly restraining losses to inflationary forces can hardly have been realized, because in this period there was no increase in prices of a statistically significant kind. Even if there had been an observable increase in general prices there would have been no certainty of waste. The costs of inflation are found in its redistributive effects, and in its eventual interference with efficiency. There is no clear evidence that these costs have any importance, or even that they exist, when inflation appears in small amounts.

50. It might be said that if there was no inflation in this period, yet there was the prospect of inflation, and that to have instituted "easy money" would have made that prospect real. If a defense is made along these lines it must be replied that the large and visible losses of known unemployment are being balanced against the doubtful and perhaps negligible losses of inflation yet to be experienced. The record of the past several years suggests that this is a major miscalculation.

51. We notice that in 1961, when on the average there was rather more than 7% unemployment, the gross national product fell just short of $37 billions. As a basis for discussion we can observe that if the $37 billions were to have expanded <u>pro rata</u> with employment it would have increased by about $2½ billions, if full employment had been achieved. Now such a calculation as it stands is unusually crude and

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inaccurate. Nonetheless it is worth considering in a qualitive way, in terms of the errors and bias it contains. That should throw some light on at least the order of magnitude of the real waste found in unemployment.

52. The possibility that output would increase pro rata with employment at once falls foul of the fact that the unemployed are not a cross-section of the labour force. Their skills are less than those of their fellow-workers, and their numbers undoubtedly include persons who are unemployed only in a nominal or statistical sense. There are the persons who have only recently entered the labour market, or who deliberately have left one job and are in the process of finding appropriate new work, and there are also other persons who are chronically without work, who are nearer to being unemployable than simply unemployed. Against this must be set the fact that as the level of unemployment rises, "permanent" unemployment becomes proportionately less important: as recently as 1953 the unemployment percentage was no higher than 3.0, and in 1947 it was actually only 2.2. Moreover, it must be remembered that if the unemployed are comparatively unskilled, they also include a higher proportion of males than does the total labour force. Even with these qualifications in mind, though, it seems certain that on balance the unemployed are prospectively less productive workers - decidedly less productive - than those who remain employed.

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53. But there are other factors. It is well

known that the average work week tends to fall as unemployment rises. The reduction of output takes on another dimension in the shorter hours of those who remain employed. Average hours worked in manufacturing, for example, fell from 41.3 in 1953 to 40.7 in 1954, rose again to 41.0 in both 1955 and 1956, and fell to 40.4 and 40.2 in 1957 and 1958. It may also be a fact, although the point is debatable, that Canadian industry in general operates under increasing returns, so that as it expands, and makes use of unemployed labour and idle resources, there is a more than proportionate increase in output. Efficiency probably increases with output. It is certainly a fact that losses are cumulative. Lost capital in one year means lost income for many years to come. Forces of this kind tend to amplify the losses that result from unemployment.

54. We leave the statistics at this point. It would be perfectly possible to attempt estimates of a much more precise kind, and to use other schemes of argument in searching for the overall loss. We are ready to conjecture that the figure of $2½ billions is at least a rough indication of the order of magnitude of the loss attributable to unemployment on 1961's scale. No doubt at lower percentages of unemployment the loss (whatever its actual value) would be reduced in a more than proportionate way; but the converse is also likely to be true, so that the proportionate loss would grow with any further deepening of unemployment. In any case if a figure of $2½ billions is even in the roughest degree a measure of recent annual losses, then

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the case for further expansion in such periods becomes overwhelming.

55. The extent of the loss is emphasized by a comparison with other economic totals. No accepted measures of total Canadian "wealth" exist, but gross fixed capital formation in 1961 came to $8.1 billions, an index to the increase of wealth that needs to be read in conjunction with depreciation allowances of about $4.4 billions. The net capital movement into Canada from abroad was in one sense very large, but it was still a little less than $1.0 billion. Personal net saving was no more than $1.3 billion, and undistributed corporation profits, rather less than $0.8 billion. Part of the increased output of a fully employed economy would have gone to increasing the stock of "wealth", and in the light of these related statistics would evidently have been large enough to make a significant increase in the net stock of wealth owned by Canadians.

56. Low rates of growth in per capita real income are quite properly associated with the unemployment levels of the last several years. There is the direct effect upon wealth and the accumulation of capital that we have just discussed. There are also indirect effects even more difficult to measure, but perhaps over the long run even more important. In periods of unemployment and stagnation it is notoriously difficult to achieve that industrial mobility on which an efficient economy depends. Workers are understandably concerned with seniority provisions and with the protection of

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the jobs they already have. Steps to liberalize trade are resisted. Innovation and automation are not welcomed as making the whole economy more productive, but instead are regarded with hostility and suspicion. As a parallel effect the existence of excess capacity slows down the introduction of new processes and modern equipment. This may be very hurtful: such authorities as Sir Roy Harrod believe that it is not so much the accumulation of capital as the steady improvement in its form that is the mainspring of economic progress.

57. The focus of the difficulties of the past several years is found in the pattern of interest rates. This is so not because of any pre-eminence of monetary policy over fiscal policy, but because of the sharp contrast between the evident need of economic expansion and a level of rates that must - so far as it was effective - have worked to prevent expansion. It may indeed be difficult to produce an exact correspondence between cycles of tight and easy money on the one hand and cycles of economic growth and contraction on the other, but it is not an exact correspondence that is at issue. There has been a period of nearly five years in which interest rates and employment rates have been out of step. Opinions may differ as to whether lower rates would have notably reduced unemployment.

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are resisted. Innovation and automation are not welcomed as making the whole economy more productive, but instead are regarded with hostility and suspicion. As a parallel effect the existence of excess capacity slows down the introduction of new processes and modern equipment. This may be very harmful: such authorities as Sir Roy Harrod believe that it is not so much the accumulation of capital as the steady improvement in its form that is the mainspring of economic progress.

57. The focus of the difficulties of the past several years is found in the pattern of interest rates. This is so not because of any pre-eminence of monetary policy over fiscal policy, but because of the sharp contrast between the evident need of economic expansion and a level of rates that must - so far as it was effective - have worked to prevent expansion. It may indeed be difficult to produce an exact correspondence between cycles of tight and easy money on the one hand and cycles of economic growth and contraction on the other, but it is not an exact correspondence that is at issue. There has been a period of nearly five years in which interest rates and employment rates have been out of step. Opinions may differ as to whether lower rates would have notably reduced unemployment. Perhaps no informed observer would argue that lower rates would of themselves have been a complete solution. But such effect as there was must certainly have been a depressing one, and must have been augmented by the [illegible] role of high interest rates as a sign of restraint

58. The depressing effect of high interest rates has been seen in several ways. First and most certainly, the fact of high interest rates has been a sign that the need for further expansion has not been accepted. Secondly, there has been the extra cost that high rates impose, costs that may make various investments impossible or force them to be reduced or postponed. Admittedly there are many investments for which interest changes can hardly have a decisive effect; but it is also true that for Quebec's municipalities, for example, "the servicing of their debts represented the principal item of expenditures, that is, 32.4% of the total" (Budget speech, 1962, p. 83). Thirdly, there has been the relative unavailability of funds at any reasonable interest rate that is often found in periods when rates have been raised. Capital markets in Canada do not have the perfection of text-book models, so that "tight money" may make its appearance in a sort of rationing of credit rather than in a simple increase in rates. There is also a tendency when rates have been raised for lending institutions to hold on to their existing assets at the expense of new items. Institutions that suffered book losses on the Conversion Loan, for example, may hold the loan rather than have the losses realized in shifting to other investments.

59. The inhibiting effect of high interest rates may therefore have more than one source, and so in a quantitative way be difficult to trace. Its existence, though, is a matter of direct experience. We can cite here some brief extracts from the informed opinion of

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the President of Quebec's Municipal Commission:

> "La raison principale qui a forcé la cité de Montréal à emprunter aux Etats-Unis, c'est que le marché canadien n'était pas en mesure d'offrir un loyer d'argent comparable à celui qui pouvait être obtenu sur le marché américain, pour des émissions capitales consécutives aussi importantes que celles faites par la Métropole. A quelques reprises, d'ailleurs, la cité de Montréal a demandé des soumissions sur le marché canadien, et elle a dû les refuser parce que le coût d'argent était trop élevé . . . "

> "Quelques villes, en dehors de Montréal, sont revenues périodiquement sur le marché américain durant les dernières années, entre autres Sept-Iles, Ste-Foy, LaSalle, Beaconsfield, Baie-Comeau et Sherbrooke. D'autres villes n'ont fait qu'une apparition au cours de l'une des dernières années . . . . 1960 avait été une année très difficile sur le marché canadien, et la prime cotée par le dollar canadien à New York encourageait les finances sur le marché des Etats-Unis. . . La raison qui a déterminé des municipalités comme Sept-Iles, Ste-Foy et Baie Comeau à venir sur le marché américain est la même que celle donnée pour Montréal: difficulté de trouver l'argent à un loyer raisonnable au Canada à cause de l'importance relative des émissions offertes."

We should add that expenditures by the Province itself, once they have been authorized, have not actually been curtailed as a result of high interest rates. But this is not really the point. The extent of provincial programmes depends upon cost, and in particular, upon interest payments. Interest payments necessarily have an important weight in public capital projects of all kinds, schools, hospitals, roads, and the rest.

60. We see in these observations one very important further result of the combination of high interest

rates and continuing unemployment. The high rates are high not only in relation to domestic needs, but in relation to rates abroad. They produce an inflow of (financial) capital, partly on the initiative of foreigners who see the attraction of profitable Canadian returns, partly on the initiative of Canadians (as in the examples just examined) who are driven to foreign markets for necessary finance. With a floating exchange rate the inflow of capital in its turn causes an appreciation of the Canadian dollar, encourages imports and discourages exports. There is further pressure upon employment. With a pegged exchange rate the inflow is reflected in an increase in exchange reserves and (unless offsetting operations occur) an expansion of the monetary base. In that case one might say that the unnaturally high interest rates tend to produce compensating effects in the foreign exchange market.

61. The anomaly of high interest rates in a period of high unemployment may well be closely connected with the exchange crisis of last summer, and the change from a system of floating exchange rates to the present fixed rate system. High interest rates, it may be argued, produced an over-valued Canadian dollar. Instead of correcting the interest rates the authorities attempted to reduce the exchange rate itself, partly by intervention in the market, partly by calling forth a speculative interest in lower rates. In the event, once manipulation of the rate was attempted, new forces entered the market, and eventually

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very strong speculative forces led to the devaluation and pegging of the dollar. It is not necessary to insist on this version of events to regret that the high interest rates persist, and have even been increased, and now have the purpose of protecting an exchange rate that for many years was successfully left to find its own level.

62. We find ourselves in some danger of having economic means and economic ends precisely interchanged. The compensatory character of federal financial programmes must surely have as their main object stable full employment. To this end interest rates must be adapted, so must budget deficits and surpluses, so must exchange rates.

63. But if the exchange rate as such becomes a fixed object of policy, then there is every chance that the position of the federal budget must be adapted to the behaviour of the exchanges. It then follows that interest rates will have to be gauged to the requirements of these new and essentially irrelevant goals. The prospect of stable full employment being attained under such a regime is discouragingly remote. The present environment may represent only short-lived, emergency arrangements; but is nonetheless true that at the moment interest rates are still high, flexibility in the federal budget has been reduced, the exchange rate has taken a fixed form, and unemployment is still unhappily high.

64. These are very general issues, and we have spoken of them in very general terms. Yet the many

high interest rates persist, and have even been increased, and now leave the purpose of protecting an exchange rate that for many years was successfully left to find its own level.

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54. These are very general issues, and we have

specific, technical problems that must come before this Commission are in a practical sense likely to be quite overshadowed by the broad choice of whether there should be less expansion or more, whether interest rates should be higher or lower, whether the tax structure should be tightened or eased. The broad decision made, as much as possible should be done in the narrower technical way to enhance efficiency, and to reduce the burden put upon the main instruments of compensatory finance. Proposals to improve capital markets, to widen communication, to extend co-ordination, all of these are undoubtedly very useful projects. But they are useful at all times and in their own right, and not as a substitute for a correct decision about the overall need for expansion.

65. We repeat our agreement that expansion cannot be attempted in an unlimited way, without regard to the waste and dislocation that inflation would ultimately impose. But in economic circumstances in any way similar to those of the past several years the case for a much greater degree of expansion seems decisive. The losses are real and immediate if stagnation is allowed to continue. The dangers from further expansion are for some time at least conjectural and small. Within the economy of Quebec there are innumerable tasks of repair and reform to be accomplished. The savings of the Province, the tax revenues of its government, will even in the best of circumstances be strained by the magnitude of the demands they must satisfy. Such facts make urgent

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the need for a fully employed economy, and underline the requirement that federal programmes of finance take on an expansionary character.

- CHAPTER IV -

FINANCIAL PROGRAMMES OF THE FEDERAL GOVERNMENT

Specific Issues

66. We turn now to issues of smaller scope and of a more specific kind. The first problem of this type on which we wish to comment is a problem raised by the Commission itself, the matter of exchange rate variation and its effect on provincial borrowing. This is not to re-open the question of whether there is a provincial interest in a floating exchange rate as such, as contrasted with a pegged or with a manipulated rate. Our view on that issue is simply that the exchange rate should never be elevated into an end of policy, but should only be regarded as a means: there is no reason to fear a floating rate, for example, if such a rate makes it easier to approach full employment.

67. The immediate point is purely technical. What effect do changes in the exchange rate have upon the scale and efficiency of provincial and municipal borrowing abroad? We can agree at once that if all exchange rates were permanently frozen, and borrowers knew of this fact, it would in principle be a matter of indifference where borrowing was done, provided interest rates were equal. (This also supposes, of course, that no differential is hidden in corporation law or in tax regulations). In the same way, if interest rates were not equal, it would be profitable to borrow in the market with the lower rate. But exchange rates are not permanently frozen. Even if they are pegged, as they are now, they are inevitably liable to adjust-

ment at some later date. It follows that borrowers must not only consider comparative interest rates, but must also weigh the losses and gains that can flow from variations in the exchange rate during the life of their loans.

68. Now, so far as borrowers are confident that they know what the pattern of exchange rates will be, they are able to make an exact computation weighing exchange variations against interest differentials. If their confidence is justified by events, the variability of the exchange rate represents nothing more than an arithmetic complication. Given changes in the exchange rate are exactly offset by given differences in the levels of interest rates. On the other hand, if events falsify the borrowers' estimates, perhaps because the borrowers have ingenuously ignored the possibility of changed exchange rates, then they will experience windfall losses and gains as interest and capital are repaid.

69. A more likely case is that borrowers are not confident but uncertain as to the future course of the exchange rate. Exact computation being impossible, they must reconcile themselves to the fact that windfall losses and gains are almost certain to occur. But it is undoubtedly true that for the typical borrower more is hazarded in a windfall loss than is won from an equal windfall gain: a schoolboard or a municipality prefers not to gamble even at equal odds. The effect of uncertainty is therefore to encourage borrowing in the Canadian market, safe

from the unknown exchange rate risk attached to borrowing abroad. The greater the uncertainty, the greater the incentive to borrow at home.

70. These propositions can be briefly summarized. High interest rates in Canada and low interest rates in the United States encourage municipalities (and other public bodies in the Province) to borrow in the American market. Anticipated changes in the exchange rate reduce or increase that incentive depending upon the direction foreseen for those changes, for example, the prospect of devaluation diminishes borrowing abroad. Insofar, however, as there is uncertainty about the pattern of exchange rates, that fact alone tends to discourage the use of American funds, and in proportion to the degree of uncertainty. In any case, the payment of interest and capital in American funds must bring windfall losses and gains to those borrowers whose estimates of exchange patterns prove faulty, and also to those who have borrowed without exact calculation.

71. What has been the practical significance of these influences? One point that is clear is that the possibility of a change in the exchange rate must be a factor in any calculated decision to borrow abroad, certainly if it is borrowing for the long run that is being considered. In the heyday of the automatic gold standard, before the first World War, borrowers could perhaps expect something approaching the permanently frozen rates that we mentioned above. In the Canada of the 1960's, though, even if a pegged rate continues

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to be used, few would affirm that such a rate as that chosen last May is likely to be maintained for the next ten or fifteen years. Whether it is an appropriate rate today is already debatable. It is almost impossible to imagine that it will be appropriate for a decade or more in a world of rapidly changing trade.

72. There is thus much less difference than one might at first imagine in the effects of fixed and floating exchange rates upon borrowing. A floating rate presents the exchange risk in direct and visible form. A fixed rate slightly disguises what is essentially the same risk. Long run borrowing abroad must now always be qualified by some uncertainty in the exchanges, regardless of official declarations or hopes about the course of the market.

73. The altogether predominant point of a practical kind, however, is the arithmetic fact that a moderate difference in interest rates is enough to compensate for a remarkably large exchange risk. The a priori evidence of the arithmetic is amply supported by experience. Few Quebec borrowers seem to have been deterred by the exchange risk, whether they have gone to the American market because the Canadian market was too narrow or because interest costs here were too high. Presumably they have noted that windfalls from unexpected changes can be gains as well as losses. But the decisive fact must usually have been that a low interest rate, or simply the availability of funds at any rate, can offset a notable amount of variability

in the exchanges themselves.

74. As to the arithmetic of these assertions, it can be developed in a variety of ways and on a variety of assumptions. It will be enough here to cite some well known conclusions by C. G. Bale. Bale considered a once and for all increase in the exchange rate, and came to the following opinion:

> "For example, if the comparable rates of interest were 6% in Canada and 5% in the United States, it would be profitable to sell a twenty-year bond, interest payable annually, as long as the ratio of the expected exchange rate to the spot rate were less than 1.1296; a ten-year (thirty-year) bond could be floated more cheaply in the United States as long as the ratio of the expected exchange rate to the spot rate were less than 1.0794 (1.1596)."

A little later he went on to say:

> "This analysis has been based on a very limited assumption about exchange rate expectations. Nevertheless, it suggests clearly that the spot rate must deviate from the expected exchange rate by a considerable amount before the incentive to float long-term bonds in the United States is eliminated, given an interest rate differential of one per cent. Consequently, the risk involved in exchange rate variation undertaken by Canadian borrowing abroad may not be great. . . . " (14)

75. Bale's conjecture has been borne out by Quebec experience in the past decade. The variability of the exchanges has not been a major factor in decisions to borrow. Up to the present it has not inflicted major net losses on provincial borrowers, although from time to time there have been those who

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(14) On the Exchange Risk Involved in Borrowing Abroad, Canadian Journal of Economics and Political Science, 1961.

have gained a little from changed rates and, more recently, those who have lost on a rather more substantial scale. It is always possible that more violent variations in some future period may change this experience, and point to contrary conclusions. But on the record as it stands, borrowing abroad is far from a function of interest differentials and the availability of money than it is of uncertainties attached to the exchange rate.

76. Leaving the foreign exchange market, we can consider next an aspect of domestic monetary policy that affects Quebec's interests. As is well known, in 1956 an understanding was reached between the Bank of Canada and the chartered banks whereby the chartered banks committed themselves to a so-called liquid assets ratio. In addition to the statutory cash ratio the banks agreed to try to maintain a minimum proportion of 15% between certain conventionally defined "liquid assets" and the total of their deposit liabilities. "Liquid assets" were to include cash reserves, day-to-day loans, and federal treasury bills. The published statistics show no occasion on which the intended minimum has been breached, although there have been many periods in which a proportion well above the minimum has been recorded.

77. It is to be noticed that day-to-day loans are advances by the chartered banks to investment dealers who have credit facilities at the Bank of Canada, and are made to allow those dealers to

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It is to be noted that day-to-day loans are advanced by the chartered banks to investment dealers who have credit facilities at the Bank of Canada, and are made to allow those dealers to

finance holdings of federal treasury bills and other short term federal securities. This means that the liquid asset ratio really extends the ordinary cash ratio in only one direction, that is, in a dependence direct and indirect upon federal treasury bills. One consequence (and this was foreseen) is that in periods of inflation the chartered banks cannot easily divest themselves of short term federal securities in order to expand their commercial loans. A further consequence, however, is that federal treasury bills are invested with a disproportionate, artificial superiority over provincial treasury bills.

78. There is the obvious fact that the chartered banks must exhibit a strong preference for securities they have undertaken to include in their reserves. Whatever the natural difference between the prices of federal and provincial bills, it will be widened by this favoured treatment of the federal bills. The immediate effect is strengthened by the preference other purchasers must have for bills with such special institutional properties and enhanced marketability. Since the market that can be efficiently supplied with treasury bills is limited, the provinces are handicapped. The conditions of public borrowing at short term are biased in favour of the federal authorities.

79. Is it reasonable that it should be? There may well be a case for arrangements that limit the ability of the chartered banks to make rapid switches from their holdings of short term public securities to

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investments of a commercial kind. There may well be a case, that is to say, for a liquid assets ratio in the abstract. But if there is, it is hardly necessary that it should discriminate against the provinces. The chartered banks might well be left to decide what proportion of federal and provincial treasury bills they would like to hold in such a ratio. Competition for scarce funds would then be on equal terms with the provinces able to offer their bills at a natural differential in relation to federal offerings.

This does not suggest, incidentally, that the Bank of Canada itself should regularly distribute its own portfolio of treasury bills between federal and provincial sources. Existing law would permit such a course, but to follow it would be inhibiting of ordinary monetary policy. The Bank would find itself subject to criticisms of a political kind, no matter what operations it undertook in particular provincial issues. The chartered banks, operating by tests of a purely financial kind, should be free from such criticisms. But does our argument go far enough? Should treasury bills of all kinds be eligible in a liquid asset ratio, not only provincial bills but bills of municipalities or even of private corporations? Probably not, although the point is debatable, depending on the intentions of the monetary authorities in establishing the liquid assets ratio. The argument we press, however, is that there should be no discrimination here between federal and provincial governments, levels of

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government that have separate, non-derivative constitutional responsibilities.

80. The issue has one further dimension. The marketing of federal treasury bills is much facilitated by the triangular arrangements linking the Bank of Canada and the chartered banks with specialist dealers in the bills. The dealers and the chartered banks are linked by the day-to-day loans the banks extend, and the dealers and the Bank of Canada are similarly linked by the willingness of the Bank to enter into purchase and resale agreements. These arrangements further enhance the marketability of the federal treasury bill over the provincial. Admittedly, they are arrangements not wholly determined by the Bank of Canada, and so may be said to spring in some degree from natural market forces. To the extent that they do depend upon the Bank of Canada, however, they are discriminatory, and fall under the same criticism that we have made of the liquid asset convention. There can be no doubt that the Bank of Canada's role is significant: the triangular arrangements we have just described would be impossible without a lender of last resort. This role, we believe, should extend equally to federal and provincial bills.

81. We can go on from this to a somewhat deeper question of discrimination, associated with the dual role of the Bank of Canada in federal finance. The Bank of Canada is charged in the preamble to its Act of incorporation with regulating "currency and credit in the best interests of the economic life

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of the nation". It is charged, in brief, with managing the supply of money. But it is also charged, when required by the federal Minister of Finance, to act as agent "in respect of the management of the public debt of Canada". It has not only to manage the monetary supply in the national interest, but the federal debt in the interest of the federal government.

82. Two sources of difficulty appear. It is easy enough to distinguish debt management and monetary management as ideas, but it is impossible to imagine them being easily distinguished in every kind of practical situation. Monetary management in Canada chiefly depends upon open market transactions, and, in practice, upon transactions in the debt obligations of the federal government. It thus continuously impinges upon the goals of the debt management. The second difficulty is with debt management proper, and the possibility of discrimination. Debt that is managed by the Bank of Canada naturally occupies a very special position, for the Bank's credit is finally the credit upon which the whole of the monetary system depends. Provincial and federal governments alike must have their debt managers, but it must be agreed that the Bank is not a debt manager like other debt managers. Debt to which it gives direct support occupies a highly privileged position.

83. How may this affect the provinces? A case in point is the relative importance the provinces place upon long term borrowing. This derives on the one hand from the behaviour of lending institutions.

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Quebec experience has been that lenders expect and want provincial securities to be issued at comparatively long term. It derives on the other hand from provincial needs. If allowance is made for dependent debt, the debt of municipalities, school commissions, crown corporations, then the usual destination of provincial borrowing is into capital projects that are themselves of a long term nature. It is customary and reasonable to finance such projects on a long term basis. But this need of the provinces for long term finance can be prejudiced if the Bank chooses to give special support to the short term part of the market. Short term and long term securities are by no means perfect substitutes, so that intervention by the Bank can change rates in one part of the market without equally affecting them in some other part. The Bank can strongly influence the structure of rates.

84. It would be unreasonable to urge the Bank to qualify its monetary policies by having to balance provincial and federal financial needs at every moment. Quebec would not want to find the Bank using provincial securities in the open market in the way it must use federal securities. Identical treatment in that area would be technically inefficient and politically impractical. The Bank of Canada must be free to pursue a general monetary policy in the national interest, using the purchase and sale of federal securities as the main instrument in its operations. A general monetary policy presents difficulties for

[illegible]

[illegible]

[illegible]tively long term. It derives on the other hand from provincial needs. If allowance is made for dependent debt, the debt of municipalities, school commissions, crown corporations, then the usual destination of provincial borrowing is into capital projects that are themselves of a long term nature. [illegible] projects on a long term basis. But this need of the provinces for long term finance can be prejudiced if the Bank chooses to give special support to the short term part of the market. Short term and long term securities are by no means perfect substitutes, so that intervention by the Bank can change rates in [illegible] in some other part. The Bank can strongly influence the structure of rates.

84. It would be unreasonable to urge the Bank to qualify its monetary policies by having to balance provincial and federal financial needs at every moment. Quebec would not want to find the Bank using provincial securities in the open market in the way it must use federal securities. Identical treatment in that area would be technically inefficient and politically impractical. The Bank of Canada must be free to pursue a general monetary policy in the national interest, using the purchase and sale of federal [illegible]

A general monetary policy presents difficulties for

the provinces, but they are difficulties that should be overcome without preventing a general policy from coming into existence.

85. It is not unreasonable, however, to propose that where the motives of the Bank of Canada are those of debt management rather than monetary control that its actions should be neutral as between federal and provincial interests. They should be neutral, that is to say, in intention, and in the sense that provincial interests are taken into account at equal weight with federal interests. We recognize that it is anything but simple to translate this dictum into working rules of a day-to-day kind. As we have said, the dividing line between monetary control and debt management is usually blurred and indistinct. Moreover, even within territory clearly identified as belonging to debt management the assessment of federal and provincial interests is likely to be uncertain and subjective. Yet with these things admitted, it is not altogether empty to press for the principle of equal treatment. The Bank of Canada has unique resources as a manager of public debt. Its mandate should be to use these resources in as non-discriminatory a way as possible. What preparations should be made in the market for a new federal issue? What support should be given the issue after its distribution? So far as these are questions of debt management they should be answered with full regard for the problems of provincial finance.

86. Before we leave this subject, we might draw

[illegible]

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31. Before we leave this subject, we might draw

attention to one final point. The need for a neutral attitude by the Bank in matters of debt management is emphasized in periods when the federal government accepts large budgetary deficits. Recent years provide several examples. In such periods, unless the deficits are financed by monetary expansion, the provinces must compete for limited funds in the face of the increased demands of the federal authorities. A privileged position for the federal borrower is then proportionately the more damaging to provincial needs.

87. There is one more of these specific issues on which we wish to comment, namely, the impact of general monetary policies upon the provinces. As we observed above, there are difficulties even with policies intended to be non-discriminatory. The central problem is the relative vulnerability of the provinces and their dependencies to general controls, and particularly, to policies of monetary restraint. Private enterprise finances a major part of its expansion out of undistributed profits. In the provincial sector this source of funds is of very little significance, and must remain so, as long as the provinces provide the social capital for which they are responsible. Policies of monetary restraint are therefore somewhat diluted in their incidence upon the private sector, but are felt at full strength in the provincial sector. It is also true that private enterprise is able to finance its programmes by equity stock and debt securities convertible into equity stock. This is again a source normally unavailable

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to the provincial sector, and again a source comparatively unaffected by general monetary policies.

88. Even from a purely economic point of view this must almost certainly lead to a misallocation of resources. The private sector is able to put into operation projects whose prospective rate of profit is less than the rate on projects the public sector is unable to finance. In the jargon of economics the marginal efficiency of capital is computed on a different basis in the two sectors, so preventing the limited resources of the Province from being put to their most productive uses.

89. The consequence is that the discipline of the market is felt with especial and disproportionate severity in the provincial sphere. The effect is aggravated by the narrowness and technical imperfection of the Canadian capital market. It is a special burden in a Quebec that must make good in the next few years a very great back-log of social capital. The need for increased public investment is urgent. At the same time it is socially and politically impossible to reduce current services. Any distortion of monetary policy that impedes the public sector in an almost accidental way is clearly intolerable.

90. What is the solution? The discussion in the preceding chapter indicates one line of remedy. The financial programmes of the federal government should always be guided by the need for full employment. Monetary restraint in the past few years has been unduly rigorous, and should be eased for the

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future. A further part of the remedy is to be found in some of the specifics of this chapter, in a deliberate attempt in the banking field to reduce discrimination against provincial securities. To complete the remedy we would go beyond the Bank of Canada and the chartered banks to other financial institutions. There too it should be possible to devise methods that give equal treatment to provincial securities in times of monetary restraint. In the final chapter of this Submission, in which our recommendations are reviewed and detailed, we suggest for consideration a number of such devices.

91. We repeat, though, since it would be easy to be misunderstood on this score, that we do not believe the Bank of Canada should be inhibited from practicing monetary policy. That indeed would prevent monetary policy from being discriminatory. It would also eliminate the considerable social income an efficient monetary policy provides.

- CHAPTER V -

OUR CURRENT METHODS OF FINANCING

92. In the preceding chapters, we have called the attention of your Commission to the financial objectives of the Government of Quebec and the means at its disposal to attain them. We now come to the techniques of borrowing as such, that is, to the various methods used by the provincial government and by local administrations. We include in this discussion some observations on the distribution of the Province's debt among the various financial institutions.

93. Like most of Canada's provinces, the Province of Quebec is free to use almost all the customary methods for the issue of its bonds. In practice these methods have not all been used. As a matter of fact, the Province has never resorted to the method of private placement, except for a single loan placed in the United States in 1959. Moreover, in the past twenty years it has never issued bonds through public tender, that is, the method whereby financial firms in general are invited through the newspapers to send in tenders.

94. However, in many instances in the past, e.g., between 1948 and 1955, particular financial groups were invited to send in tenders. Canadian bond market conditions were then exceptionally favorable, and the amount of the loans was not very large. (15) It was thus possible to stimulate

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considerable interest among the various groups, and then to accept the most advantageous of the tenders.

95. However, as a result of the tightened credit conditions prevailing after 1955, it became advisable to cease this practice, and to group financial institutions in order to ensure the success of our issues. For all practical purposes, Quebec has since then negotiated with a single syndicate, (16) comprising two groups, each of which includes several investment firms. In turn, the two firms in charge of the groups head the syndicate as a whole. No formal agreement binds the government to either group. Secondary distribution is done through dealers, except that the large investment firms are directly provided for by the leaders of the groups.(17)

96. Until recent years Quebec rarely resorted to loans. (See appendix, Table III). The government resorted to long-term loans to redeem maturing bonds, and to short-term loans as occasion demanded.

Renewal loans, which were made about once a year, ranged generally from \$15 to \$20 millions. In the fiscal years ending in 1956, in 1957 and in 1960, the government placed only four issues in a total amount of \$110,000,000.

Now that our loans are more numerous and more important, our syndicate is continuously informed

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(16) There was a time when the syndicate comprised three groups.

(17) Detail of the participation of these lending institutions in the most recent issues of the Province will be found in Tables V and VI of the appendix.

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of the financial needs of the Province. The syndicate analyses market conditions and submits its offers when conditions are good.

97. It is obvious that bond offerings through a single syndicate means numerous undeniable advantages, particularly when the amounts involved are large. The importance of such issues necessitates the support of as many investment firms as possible. Experience showed that public tenders were apt to have a dividing effect on the market, and did not allow the strengthening of relations between dealers and customers because the latter were never the same from one issue to another. Dealing with a sole syndicate allows the mustering of market forces and the assurance of continued interest of the syndicate's customers towards our bonds.

98. The problem of arranging the timing of their bond issues by the various provinces has already been emphasized before your Commission. Up till now no major difficulties seem to have been experienced. As a matter of fact, for all provinces, Quebec included, pertinent information is generally provided once or twice a year to the various fiscal agents. Close liaison is maintained between them so as to avoid placing more than one important issue on the market at the same time. This is one of the reasons why we do not think it necessary to establish an information centre, whatever the controlling body may be.

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our loans. Besides, experience has shown that it would be difficult to secure purchasers for all years in the series. The Province instead issues bonds on a sinking fund basis. (18) In general, to meet purchasers' requirements, each issue includes bonds spread over two or even three maturity dates. The repayment period of the bonds, at the time of issue, ranges from five to twenty-five years. As a rule, the Province endeavours to sell as many "long-terms" as possible, but all depends on the buyers' preferences.

100. Our bonds are issued in units of $1,000 or more. There was a time when units of $500 and even $100 were sold, but since they were not in great demand they were discontinued. (19) It seems that in Ontario the demand for shares of these denominations is more important. Should it become necessary, we would not hesitate once again to issue bonds of these denominations.

101. In addition to long-term loans, the provincial treasury must sometimes resort to short-time borrowing. Ordinarily this happens in the fall when outlays exceed receipts. Then arrangements must be made to have the banks carry us over until the situation is reversed, and we are in a position to pay off these advances. The Province resorts to short-term loans in other circumstances, particularly for

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(18) Sinking funds on the maturity date of the loans outstanding on December 31, 1962, will be found in the appendix, Table IV.
(19) In 1957, of a $35 millions bond issue by Hydro-Quebec only $54,000 were sold in units of $500. In the same year, of a $25 million bond issue of the Province, only $153,000 were placed in units of $500.

[illegible]

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capital expenditures when long-term financing is yet to be arranged.

102. The usual practice is then to issue treasury bills maturing more or less in the period of the year when income exceeds outcome. These treasury bills, dated for a period not exceeding three months, bear the prime rate of interest. The banks usually hold them till their maturity date, although the banks could trade them on the market. They agree ordinarily to the advance redemption of the bills at the request of the Province.

103. In the past, the total amount of treasury bills outstanding has at times just passed the $80,000,000 mark. In using this method of financing our operations certain difficulties have been encountered. More particularly, in August 1959 the banks informed the government that they were compelled to refuse to accommodate the provincial Treasury. The Canadian bond market was then going through a difficult period, and so we had to place a long-term loan in the United States sooner than we intended. The financing of government outlays in fact proved to be particularly difficult from September to December of 1959.

104. We may point out that the rate fixed by the chartered banks for short-term loans to the provincial Treasury appears to have various elements of rigidity of a detrimental kind. The rate does not follow the general trend of interest rates, and particularly, the rate on the treasury bills of the

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Federal Government. It follows that the differences between the rates paid by the Province and the Federal Government for their short-term loans are hard to justify. In particular, in September 1960, the rate charged by the banks for Quebec treasury bills was 5.75%, while the net cost of Federal treasury bills stood at only 1.25%.

Moreover, though the rate on Federal treasury bills has dipped recently, that on Provincial treasury bills has nevertheless been pegged at 5.75% since November 1962. It is obvious that a less rigid attitude by the banks would be welcome. As a matter of fact, the rate fixed by the banks should fluctuate at a level only slightly above that charged for the Federal Government's bills, and should vary in the same direction. Provincial treasury bills are negotiable, so there is no reason why we should not be able to borrow at a lower rate than private enterprise.

105. We may now turn to the financing of expenditures by the Municipal and School Corporations. These bodies often resort to the banks to finance their current outlays and capital expenditures, in the period before they consolidate their debt. Ordinarily it is out of the question for them to issue treasury bills for these bank loans. When they do come to consolidate their capital expenditures, the Municipal and School Corporations proceed, as a rule, by way of public tenders.

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sold "above the counter" to private individuals at the offices of the Municipal and School Corporations. The volume of sales made by this method is not usually very large: in the last ten years less than 1% of municipal and school bonds were sold this way.

107. Repayment periods for the bulk of school and municipal bonds run from 10 to 40 years. Such bonds are sold in serial form, except those issued by the most important School and Municipal Corporations. Except in response to a specific demand, the certificates are never printed in units of less than $1,000, since investment dealers are unable to find customers for smaller units.

108. Such difficulties as arise in the financing of Municipal and School Corporations are not as a rule the result of a badly organized market. Enough specialized dealers exist, we believe, to guarantee that the market is kept well-informed about the bonds of these Corporations. Difficulties mainly appear when the general monetary situation is deteriorating.

109. We can turn to an analysis of the distribution of the debt of the Province among the various types of financial institution. The prime fact that which strikes us is the diminution of the relative (and even absolute) importance of chartered bank holdings of provincial bonds. Since there is no reason to believe that Quebec bonds are more favoured by the banks than those of the other provinces, we can offer comments based on the

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statistics for Canada as a whole.

110. We recognize the fact that as private enterprises the chartered banks seek to invest their resources in bonds and in other negotiable instruments so as to increase profits while reducing risks and meeting the Bank of Canada's requirements. Nevertheless, it seems that the change that has taken place since 1947 deserves to be brought to your attention.

111. The fact is that the total amount of provincial bonds held by the chartered banks has been reduced greatly since that date. On December 31, 1947, the banks held $448 millions in provincial bonds, that is, 7.03% of their total assets. They held only $352 millions on December 31, 1961, a decline of about $100 millions. That amount represents only 2.5% of total assets.

Besides, even a rapid survey of the trend in the proportion of the provincial debt held by the chartered banks still more clearly illustrates this orientation of the banks' policy. Whereas in 1947 they held 20% of the total direct and indirect debt of the provinces, that proportion stood at only 5% in 1960. (20) To maintain the 1947 ratio, the chartered banks should hold four times more bonds of the

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(20) The figures for these two years are not directly comparable. (See Bank of Canada, Statistical Summary, 1961). It remains true, however, that from 1948 to 1956, the total amount of Provincial bonds held by the chartered banks decreased from $408 to $269 millions. While their assets increased from $7,649 to $12,059 millions, the debt of the provinces rose from $2,346 to $4,630 millions. Between 1957 and 1961, these total amounts rose respectively from $285 to $352 millions, and from $12,417 to $15,665, while the debt figures increased from $5,177 millions, in 1957 to $7,033 millions in 1960.

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provincial governments than they do, e.g., about $1.5 billions. It should be noted, by the way, that the increase of the primary reserves of the chartered banks, which has permitted them to increase their total assets, has in no way been used to facilitate provincial financing.

112. In the past, this situation has never presented any major problem, since for many years Quebec has borrowed very little. In fact, between 1945 and 1959, the net funded debt decreased from $340.7 millions in 1945 to $332.2 millions by March 31, 1959. During the same period, Ontario's net funded debt increased from $560.8 to $1,445.9 millions. (21) The same thing applies for the indirect debt, of which the main element here as in Ontario is constituted by that of the Hydro-Electric Commission. While the Province of Ontario increased its debt by about $1,353 millions from 1945 to 1959, the increase in Quebec amounted to only $710 millions. As we have already mentioned, it follows that the direct and indirect debt of Ontario was in 1960 two and a half times as large as that of Quebec.

113. The fact that our direct debt has remained more or less stationary illustrates why the government must now satisfy the accumulated needs of many years. The loans which we will now have to place are of a quite different dimension from those of the past several years. The burden of these new loans would

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have been the lighter if the previous government had not applied itself solely to debt reduction instead of meeting the urgent needs of the Province as was being done by other provincial governments throughout the country. But facts are facts and they have to be confronted. In present circumstances, it is understandable that a contribution by the chartered banks to provincial financing on the same scale as it once was would be welcome. As matters stand, it is obvious that the distribution of assets held by the chartered banks is not favourable to the provinces.

114. This situation is all the more surprising when it is considered that the responsibility of creating the economic infrastructure necessary to the development of private enterprise falls more and more on the provinces. Since in our Province, as elsewhere, the increase of our borrowings is partly due to the transfer of responsibilities from the private sector to the public sector the financial institutions should take that fact into consideration in the distribution of their portfolios.

115. It would therefore seem appropriate for the Commission to examine the criteria guiding the selection of financial portfolios, and to suggest various means for achieving a balance in the financing of the various levels of government and of private enterprise. Provincial bonds would thus be placed in a more equitable competitive situation. Finally, a greater total of investment would be directed where essential tasks must be fulfilled.

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114. This situation is all the more surprising when it is considered that the responsibility of creating the economic infrastructure necessary to the development of private enterprise falls more and more on the provinces. Since in our Province, as elsewhere, the increase of our borrowings is partly due to the transfer of responsibilities from the private sector to the public sector the financial institutions [illegible] in the distribution of their portfolios.

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- CHAPTER VI -

RECOMMENDATIONS AND CONCLUDING REMARKS

116. We can now bring together the various recommendations that have been explicit or implicit in earlier parts of this Submission. To this summary we can also add a brief discussion by way of final commentary on the issues before the Commission.

117. We can remark first on the spirit in which these recommendations are proposed. Needless to say, they touch on only a small proportion of the topics on which the Commission and its staff must presumably come to some opinion. We leave untouched many questions that are of interest to everyone, but on which a provincial government has no special need to make representations. Then there are numerous questions of a basically technical kind, questions on which representations from a provincial government or from anyone else are not likely to be of much use till careful research into the facts has been achieved, questions that are indeed answered at once by the facts.

118. But even within those areas of banking and finance where the Province of Quebec has a special interest these recommendations do not pretend to be a complete statement of the provincial position. There are several reasons why this is so. On a question of such overriding importance as the distribution of the taxing power, involving as it does great constitutional issues, the Province must naturally proceed through intergovernmental channels to the main presentation of its case. There are various problems in which matters

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of purely provincial interest appear, in which the difficulties are local and the solutions are local: on these too, it is not necessary to comment in detail. No doubt too, there are problems on which representations should be made but which have not yet been properly recognized or appraised. On problems of finance, as on many other problems, the Province has now to make good as rapidly as possible lost time and lost opportunities.

119. The main thesis that we have argued is a simple one. The economic responsibilities of the provinces are growing at a rapid rate, as population grows, as technology becomes more complex, as well-founded demandsfor social capital expand. These responsibilities not only are growing more rapidly than those of the federal government, but the particular responsibilities of Quebec are growing even more rapidly than those of the other provinces because of the depressed base on which Quebec growth must build. It follows that the financial resources of the Province must also expand at a particularly rapid rate if the Province is to discharge its responsibilities.

In the Budget Speech delivered to the Legislative Assembly in April of 1962, the position was put in these words:

> "Now the rigorous analysis of the real situation leads to an inescapable conclusion: Quebec, owing to the minority character of its population, to the urgency of the task that it has set for itself and to its responsibilities in the field of economic development, has prior and essential needs that it cannot satisfy by reason of the division of

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fields of taxation that now prevails in Canada. In one word, it does not have the fiscal means for realizing the objectives that the whole population would wish to see accomplished".

We do not ask and do not expect the Commission to attempt to adjudicate this proposition. We present it as a definition of the central problems of finance as it is seen by the Province. As such, it can serve the Commission as a guide in interpreting every aspect of this Submission.

120. The redivision of the fields of taxation is urgently needed. In the meantime the Province cannot hope to cover even essential needs from current revenues, but must expect to go to the capital market, from time to time and in a substantial way. Undoubtedly it is true that even after a redivision of tax fields, provincial borrowing would often be desirable and would sometimes be necessary. It will always be true that municipalities and the rest will depend upon borrowing for an important part of their needs. But at the present juncture, with tax reform still to be achieved, the Province and the public sector within the Province are especially dependent upon efficient access to the Canadian capital market. In general terms, therefore, we strongly recommend to this Commission the need for "equal access" rules, that is, the need for measures likely to give the provinces and the public sector within the provinces equal access with the rest of the economy to the Canadian supply of savings.

121. Redivision of tax powers and equal access

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to capital markets are two aspects of the solution of the Province's financial needs. A third lies in the renewal of expansion in the national economy. With economic growth comes even more rapid growth of provincial revenues. We can repeat in brief the detailed argument made earlier. For several years past, the economy has exhibited the classical signs of stagnation, thus, a low rate of growth, and chronic unemployment. Nonetheless, throughout this period expansionary economic policies have not been pressed, and interest rates in particular have been allowed to remain at high levels. It appears, we have argued, that these paradoxical facts are to be explained by an exaggerated fear of inflation. We therefore repeat the recommendation made earlier, that expansionary policies be boldly adopted, that interest rates be reduced and that much greater weight be given to the tangible losses of unemployment when these are balanced against the latent possibility of harmful inflation. It is worth remarking that if expansionary policies can eventually cause <u>inflationary</u> spending, they must first cause spending, and that is surely useful enough in an economy suffering from a shortage of demand.

122. We turn from these general recommendations to a recapitulation of specific suggestions. These relate almost entirely to the "equal access" problem, since on the questions of tax redivision and full employment we have not sought to go beyond the argument of the main position. (As we suggested above,

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a detailed and technical discussion of tax redivision belongs to intergovernmental negotiations).

123. As one element in "equal access" we recommend that provincial treasury bills be given an equal place with federal treasury bills in the liquid assets ratio of the chartered banks. Provincial bills should never be at more than a small discount in relation to federal bills. We recommend too that any similar arrangement determined in the future between the Bank of Canada and the chartered banks should in the same way be non-discriminatory as between federal and provincial securities. The principle of non-discrimination should also extend to money-market arrangements, at least so far as these arrangements fall within the ambit of the Bank of Canada.

We have observed in this connection that at the end of 1961 the chartered banks held only 2½% of their assets in provincial bonds, a decline from a figure of 7% at the end of 1947. Bank holdings of federal securities also fell during this period, but it is noteworthy that the fall was proportionately much larger for the provincial securities, and reduced holdings to a very low absolute level. We therefore recommend that the chartered banks be urged to review their portfolio policies to discover if any purely conventional rules are acting as a bar to the holding of provincial securities.

124. It seems probable, however, that federal securities are given an artificial superiority to provincial securities by the debt management functions

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of the Bank of Canada. The treasury bill is in this sense simply an illustration of a more general problem. We recommend that the Commission (and the Bank of Canada itself) consider the feasibility of the following rule: in its debt management functions the Bank should as far as possible give equal weight to federal and provincial interests. There are admittedly difficulties in a complete application of the principle, stemming chiefly from the interdependence of debt management and monetary management. It is nonetheless true that the provinces may often have a preference for one interest rate structure, usually favouring the longer term issues, and the federal authorities for another; the provinces may often want stable markets at one period of time, the federal authorities at another; the provinces and the federal authorities may often have competing needs. We recommend that debt management by the Bank should give no automatic priority to the federal interest, but should be neutral in principle and neutral as far as may be in practice.

125. The problem of "equal access" goes deeper, however, than the direct relationship with the Bank of Canada. Methods of finance in Canada are such that the public sector, at the level of the provinces and their dependencies, is inevitably handicapped vis-à-vis the private sector. The chief reason, of course, is the special vulnerability of the provincial sector to any pattern of credit restriction. Unlike the federal authorities, the

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provincial authorities are not the final source and support of the nation's monetary supply. Unlike the private sector, the provincial sector can rely in only a very limited way on finance from undistributed profits and from the various forms of equity capital. All of this is in the nature of things. The provincial responsibility is particularly directed to social capital, and social capital does not have the same self-financing relationship to the market that industrial and commercial capital must normally have.

126. This is not simply special pleading for a special interest, nor is it an attempt to ascribe unusual virtues to social capital as such (although the real virtues of social capital are often overlooked). The immediate, objective economic fact is that unequal access to the national supply of savings must lead to a misallocation of national resources, and must from that fact alone be inefficient and wasteful. We therefore recommend that measures be taken to remedy this imbalance, allowing a higher proportion of the national savings to go to the public sector of the provinces.

127. As a consequence, the measures that should be examined are those that make the securities of the provincial sector more attractive to lenders or that in one way or another subsidize provincial capital needs. There are many possibilities worth investigation. For example, changes could be urged in the conventions governing the portfolio policies

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of the life insurance companies and other financial intermediaries. If necessary, statutory changes might be introduced to the same effect.

128. We draw attention once again to the fact that federal subsidization in any form is not a satisfactory substitute for tax redivision where needs have permanently changed. Subject to this point, we have listed possibilities rather than make a choice or particular recommendation. None of these possibilities is likely to be a complete solution, and none has advantages that are free from any off-setting disadvantages. Our hope here is that the Commission will accept the need for remedies of this general pattern to be applied. The statistical evidence on the distribution of provincial securities really speaks for itself on this score. As to the choice of remedies we hope that the Commission, supported by the researches of its technical staff, will be able to offer an opinion as to which methods are likely to be most efficient, and to be easiest to graft on to existing arrangements. Indeed it is on just this kind of issue that the professional opinion of the technicians should be of most value to all interested parties.

129. One further specific point: on the question of the exchange rate we offered a number of comments because we gathered the Commission had an especial interest in the topic, and in the experience various borrowers in the American market had to report. We do not want to add to these comments a

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formal recommendation, although we might observe that it would be folly to allow the exchange rate as such to become an object of policy instead of a mere instrument or tool. A fixed rate, or a floating rate, or even a manipulated rate, is of no value in itself but only as it assists or hampers public policy.

130. In closing we might remark on how exceptionally difficult the work of the Commission must be. Its task is to determine how best the banking and financial system can serve national interests and national needs: its client is the general public. Yet on most of the issues before the Commission the general public is remarkably uninformed, and has no easy way of making direct or technically sophisticated representations of its interests. The expert briefs, the technically proficient submissions, must come from those who are professionals in the financial field, from the chartered banks, from the Bank of Canada, from the investment dealers, and so on.

131. The Commission will undoubtedly avoid to simply balance the evidence brought before it, reporting the judgments that evidence points to, but will surely carry out its own investigations and then in a sense become the objective judge of the facts its own researches have uncovered. It is a formidable and challenging responsibility. Yet how else - to take one example of many - how else will such a question as the maximum interest rate on bank lending be tested?

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The facts on such a question will undoubtedly be scrutinized before a sensible judgment can be formed, and the facts so far available to the public are scattered and incomplete. It is on such matters that we wait with confidence not only for the recommendations the Commission will eventually make, but for the supporting documentation and independent technical evidence to which those recommendations are related.

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A P P E N D I X

S T A T I S T I C A L   T A B L E S

TABLE I

QUEBEC - HYDRO

Financial requirements 1962-1971

(in millions of dollars)

	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971
FINANCIAL REQUIREMENTS										
Real estate investments	$149.1	144.4	228.2	236.8	135.2	140.1	114.5	122.6	119.9	124.8
Redemption of debentures at maturity	58.9	2.0	8.0	21.5	20.5	42.5	2.5	36.5	2.0	2.0
Investments for sinking fund purposes	9.3	11.1	12.7	15.1	17.7	19.3	22.2	20.8	26.0	28.2
	217.3	157.5	248.9	273.4	173.4	201.9	139.2	179.9	147.9	155.0
SOURCES OF FUNDS										
Proceeds from the operation of the year (additions to reserves)	54.3	58.1	67.4	77.0	78.8	85.6	95.2	109.3	120.8	132.5
Proceeds from the issue of debentures	146.2	97.5	195.0	195.0	87.8	116.8	39.0	73.1	24.4	24.4
Decrease in working capital (or increase)	16.8	1.9	(13.5)	1.4	6.8	(.5)	5.0	(2.5)	2.7	(1.9)
	217.3	157.5	248.9	273.4	173.4	201.9	139.2	179.9	147.9	155.0

The source and application of funds for the five years preceding 1962, are shown in Table II.

Source: The Quebec Hydro-Electric Commission, May 1962.

TABLE II

QUEBEC - HYDRO

Source and Application of Funds, 1957-1961
(In millions of dollars)

SOURCES OF FUNDS	1957	1958	1959	1960	1961
Proceeds from the operation of the year (additions to reserves)	$ 50.5	52.7	54.9	53.3	54.1
Proceeds from the issue of debentures	94.8	106.7	110.8	87.7	97.8
Sale of the gas properties	32.9				
Decrease in working capital (or increase) and sundries	28.7	(19.)	(29.4)	28.7	.3
	206.8	140.4	136.3	169.7	152.2

APPLICATION OF FUNDS	1957	1958	1959	1960	1961
Real estate investments	141.2	134.0	96.5	120.3	142.8
Redemption of debentures at maturity	63.2	2.2	35.1	44.5	1.9
Investments for sinking fund purposes	2.4	4.2	4.7	4.9	7.5
	206.8	140.4	136.3	169.7	152.2

Source: See Table I

TABLE III

Yield, term to maturity and amount of Provincial
Bords issued since January 1952.

ISSUE a) year	b) date	term to maturity (years)	AMOUNT ($000,000)	YIELD TO PURCHASER %
1952	Dec., 1	20	25	3.38
	Dec., 15 (1)	10	15	4.08
1953	April, 15	13	26	4.05
1954	Feb., 1	13	25	3.87
	July, 1	15	34.5	3.25
1955	June, 1	6	23.25	2.75
	July, 1 (2)	18	37.75	3.30
1956	--	--	--	--
1957	June, 15	20	25	4.90
1958	--	--	--	--
1959	Oct., 1	20	25	5.37
1960	August, 15	8	7.7	5.25
	August, 15	21	42.3	5.54
1961	Feb., 1	7	12.5	5.43
	Feb., 1	25	37.5	5.81
	June, 1	5	13.0	5.23
	June, 1	19	37.0	5.70
	April, 1	6	8.0	4.90
	April, 1	24	42.0	5.40
1962	June, 15	7	15	5.00
	June, 15	21	35	5.45
	April, 2	10	15	5.00
	April, 2	22	45	5.35
	August, 1	10	10	6.00
	August, 1	20	40	6.09
	Dec., 15	6	19.5	5.05
	Dec., 15	25	40.5	5.45

(1) In addition, the Province borrowed $12.6 millions for 6 months on April 1st, and $13.4 millions, for 4 months, on June 1st.

(2) In addition, the Province borrowed, on March 25, $10 millions for 4 months and $15 millions for 6 months.

Source: Department of Finance of the Province of Quebec.

TABLE IV

PROVINCE OF QUEBEC

Loans outstanding as at December 31, 1962 and sinking fund at date of maturity
(in thousands of dollars)

Date of maturity	Amount $	Sinking fund at date of maturity $
January 2, 1963	9,000	9,161.2
October 1, 1963	23,725	7,222.8
March 1, 1964	15,000	15,072.
September 15, 1964	15,000	3,998.3
March 15, 1965	35,000	11,445.6
April 15, 1966	26,000	4,025.
June 1, 1966	13,000	700.6
February 1, 1967	25,000	4,184.2
August 1, 1967	8,000	527.3
February 1, 1968	12,500	996.3
August 15, 1968	7,700	613.2
January 15, 1969	15,000	1,184.7
July 1, 1969	34,500	10,864.
October 1, 1970	25,000	8,635.6
April 1, 1971	50,000*	22,787.4
April 2, 1972	15,000	1,821.9
December 1, 1972	25,000*	9,009.8
July 1, 1973	37,750	8,849.2
January 15, 1977	25,000	7,487.8
October 1, 1979	25,000	7,458.
June 1, 1980	37,000	11,022.
August 15, 1981	42,300	14,693.
July 15, 1983	35,000	15,630.
April 2, 1984	45,000	16,823.
August 1, 1985	42,000	18,088.
February 1, 1986	37,500	17,292.
August 1, 1972	10,000	1,200.6
August 1, 1982	40,000	13,226.3
December 15, 1968	19,500	1,293.4
December 15, 1987	40,500	19,329.4
	790,975	264,642.6

Repayment of this issue will be made out of the highway network fund.

Source: See Table III.

TABLE V

PROVINCE OF QUEBEC

Initial distribution of Province bonds issued since August 15, 1960

	$50,000,000 on August 15, 1960 (in thousands of dollars)		$50,000,000 on February 1, 1961 (in thousands of dollars)		$50,000,000 on June 1, 1961 (in thousands of dollars)	
	$7,700 at 5¼% - August 15, 1968	$42,300 at 5½% - August 15, 1981	$12,500 at 5¼% - February 1, 1968	$37,500 at 5¾% - February 1, 1986	$13,000 at 5% - June 1, 1966	$37,000 at 5½% - June 1, 1980
Quebec Banks	350	1,350	1,200	300	2,475	850
Ontario Banks	100	1,100	500	750	1,000	950
Quebec-Hydro				150		
Ontario-Hydro		1,000				
Quebec Insurance Companies		3,200	500	525	50	2,100
Ontario Insurance Companies		4,225	150	6,400		1,900
Western Provinces Insurance Companies						750
U.S.A. Insurance Companies	250			1,000		1,000
Quebec Trust Companies	25	175		100	540	646
Ontario Trust Companies	450	200	150	50	100	50
Maritimes Trust and Insurance Companies		100		25		
Workmen's Compensation Commission		2,000		1,500		800
Caisses Populaires	1,225		2,600		1,250	
TOTAL	2,400	13,350	5,100	10,800	5,415	9,046

TABLE V (cont'd)

	$50,000,000 on August 1, 1961 (in thousands of dollars)		$50,000,000 on January 15, 1962 (in thousands of dollars)		$60,000,000 on April 2, 1962 (in thousands of dollars)	
	$8,000 at 4¾% August 1, 1967	$42,000 at 5¼% August 1, 1985	$15,000 at 5% January 15, 1969	$35,000 at 5¼% July 15, 1983	$15,000 at 5% April 2, 1972	$45,000 at 5½ April 2, 1984
Quebec Banks	2,500	1,250	2,600		870	100
Ontario Banks	1,750	200	2,800	350	300	1,500
Quebec-Hydro		200		200		250
Ontario-Hydro						
Quebec Insurance Companies		1,900	100	2,775		825
Ontario Insurance Companies		4,500	100	1,500	100	3,600
Western Provinces Insurance Companies		750				1,000
U.S.A. Insurance Companies		250				350
Quebec Trust Companies		600	150	200	1,050	2,085
Ontario Trust Companies	10	35	150	175	225	225
Maritimes Trust and Insurance Companies						
Workmen's Compensation Commission		750		2,500		1,000
Caisses Populaires	810	50	2,250		2,150	
TOTAL	5,070	10,435	8,150	7,700	4,695	10,935

Source: See Table III

TABLE VI

Summary of Table V

(2)	Aug. 15/68	Aug. 15/81	Feb.1/68	Feb. 1/86	June 1/66	June 1/80	Aug. 1/67	Aug. 1/85	Jan.15/69	July 15/83	Apr. 2/72	Apr. 2/84
Quebec	1,600.	6,725.	4,300.	2,575.	4,315.	4,396.	3,310.	4,750.	5,100.	5,675.	4,070.	4,260.
Ontario	550.	6,525.	800.	7,200.	1,100.	2,900.	1,760.	4,735.	3,050.	2,025.	625.	5,325.
Maritimes		100.		25.								
Western Canada						750.		750.				1,000.
United States	250.			1,000.		1,000.		250.				350.
TOTAL	2,400.	13,350.	5,100.	10,800.	5,415.	9,046.	5,070.	10,485.	8,150.	7,700.	4,695.	10,935.

(1) The initial distribution of two recent bond issues by the Province and by Quebec-Hydro appears on Table VII.

(2) These are the dates of maturity of the bond issues referred to in detail in Table V.

Source: See Table III.

TABLE VII

PROVINCE OF QUEBEC

INITIAL DISTRIBUTION OF TWO RECENT ISSUES OF THE PROVINCE AND HYDRO-QUEBEC BONDS (in percentages).*

	PROVINCES AND COUNTRIES						
	Quebec	Ontario	Maritime Provinces	Western Provinces	United States	Foreign Countries	Total
Banks	8.9 %	4.7 %	- %	0.1 %	- %	0.3 %	14.0 %
Caisses Populaires	4.1	-	-	-	-	-	4.1
Insurance Companies	7.1	7.1	0.2	1.6	2.0	0.8	18.8
Trust Companies	5.1	3.1	0.2	0.4	-	-	8.8
Pension Fund	2.7	1.7	0.2	0.2	-	-	4.8
Government Institutions	6.6	0.8	0.4	1.3	-	-	9.1
Other institutions	3.3	1.5	-	0.5	-	0.1	5.4
Sales to the public	10.8	4.0	0.1	1.6	-	-	16.5
Sales to other dealers	9.4	4.7	0.1	0.1	0.1	0.2	14.6
	58.0 %	27.6 %	1.2 %	5.8 %	2.1 %	1.4 %	96.1 %

* Initial distribution of the following bonds:

a) $50,000,000 Province of Quebec, January 15, 1962
b) $60,000,000 Province of Quebec, April 2, 1962
c) $50,000,000 Quebec Hydro-Electric Commission, November 1, 1961
d) $60,000,000 Quebec Hydro-Electric Commission, March 1, 1962.

Source: A.E. Ames & Co. Ltd.

TABLE VIII

Sales of municipal and school bonds by public tenders, by mutual agreement and over the counter, (1952-1962).

MUNICIPAL BONDS (000,000)

Year	Public tenders (1)		Mutual agreement		Over the counter		Total
1952	(76)	$ 24.5	(68)	$30.2	(31)	$1.6	$ 56.3
1953	(119)	34.3	(35)	7.0	(30)	0.6	41.9
1954	(139)	35.3	(29)	32.8	(11)	0.3	68.9
1955	(110)	47.8	(10)	41.7	(26)	0.7	90.2
1956	(77)	42.5	(61)	42.4	(16)	0.9	85.8
1957	(135)	60.4	(47)	43.0	(32)	1.5	104.9
1958	(148)	81.0	(22)	67.7	(35)	1.2	150.0
1959	(137)	66.8	(48)	70.4	(34)	1.9	139.1
1960	(198)	89.1	(79)	93.2	(20)	1.1	183.4
1961	(218)	84.2	(37)	64.5	(23)	2.2	151.0

SCHOOL BONDS (000,000)

Year	Public tenders (1)		Mutual agreement		Over the counter		Total
1952	(86)	26.6	(84)	11.9	(4)	0.2	38.7
1953	(84)	19.9	(47)	8.3	(9)	0.9	29.1
1954	(139)	31.7	(49)	3.0	(1)	0.0	34.7
1955	(110)	38.0	(64)	21.3	(12)	0.6	59.9
1956	(77)	20.2	(77)	36.2	(2)	0.1	56.5
1957	(135)	28.2	(88)	29.4	(14)	0.7	58.3
1958	(148)	36.0	(64)	21.0	(8)	1.6	58.6
1959	(127)	34.2	(113)	40.4	(9)	0.7	75.3
1960	(198)	42.0	(80)	30.4	(1)	0.1	72.6
1961	(218)	58.7	(81)	25.1	(8)	0.5	84.2

(1) Figures in parentheses represent the number of issues.

Source: Quebec Municipal Commission.